CANADIAN FEDERALISM:
Meeting Global Economic Challenges?

Douglas M. Brown/Murray G. Smith
Editors

The Institute of Intergovernmental Relations

The Institute is the only organization in Canada whose mandate is solely to promote research and communication on the challenges facing the federal system.

Current research interests include fiscal federalism, constitutional reform, the reform of federal political institutions and the machinery of federal-provincial relations, Canadian federalism and the global economy, and comparative federalism.

The Institute pursues these objectives through research conducted by its own staff and other scholars through its publications program, seminars and conferences.

The Institute links academics and practitioners of federalism in federal and provincial governments and the private sector.

……

L'Institut des relations intergouvernementales

L'Institut est le seul organisme canadien à se consacrer exclusivement à la recherche et aux échanges sur les questions du fédéralisme.

Les priorités de recherche de l'Institut portent présentement sur le fédéralisme fiscal, la réforme constitutionnelle, la modification éventuelle des institutions politiques fédérales, les nouveaux mécanismes de relations fédérales-provinciales, le fédéralisme canadien au regard de l'économie mondiale et le fédéralisme comparatif.

L'Institut réalise ses objectifs par le biais de recherches effectuées par son personnel et par des universitaires de Queen's University et d'ailleurs, de même que par des conférences et des colloques.

L'Institut sert de lien entre les universitaires, les fonctionnaires fédéraux et provinciaux et le secteur privé.

91-05071/

CANADIAN FEDERALISM:

Meeting Global Economic Challenges?

CANADIAN FEDERALISM:
Meeting Global Economic Challenges?

Douglas M. Brown/Murray G. Smith
Editors

Institute of Intergovernmental Relations
Institute for Research on Public Policy

Canadian Cataloguing in Publication Data

Main entry under title:

Canadian federalism : meeting global economic challenges?

Co-published by the Institute for Research on Public Policy.
"Proceedings of a conference held in March, 1990 at Mont Gabriel, Quebec entitled Canadian federalism: global economic challenges." — Foreword.
Includes 4 chapters in French.
ISBN 0-88911-574-5

1. Canada - Foreign economic relations - Congresses.
2. Canada - Economic policy - 1971 - - Congresses.*
3. Federal government - Canada - Congresses.
4. International economic relations - Congresses.*

I. Brown, Douglas Mitchell, 1954- . II. Smith, Murray G. (Murray Gordon), 1952- . III. Queen's University (Kingston, Ont.). Institute of Intergovernmental Relations. IV. Institute for Research on Public Policy. V. Title.

HF 1479.C35 1990 337.71 C91-093074-0

Copyright © 1991 Institute of Intergovernmental Relations
Queen's University
Kingston, Ontario
K7L 3N6
and
The Institute for Research on Public Policy
P.O. Box 3670 South
Halifax, Nova Scotia
B3J 3K6

Contents

Foreword *ix*
Avant-propos *xi*
Acknowledgments *xv*

Introduction

Introduction 3
Douglas M. Brown and Murray G. Smith

I Canada and the Global Economy

Discours d'ouverture 21
Roger Charbonneau

Chairman's Remarks: Constraints and Opportunities 23
Germain A. Denis

Europe in the 1990s: Coping with Internal and External Economic Change 27
André Sapir

Canada in the 1990s: Coping with Internal and External Economic Change 43
Thomas J. Courchene

Session I — Digest of Discussion 53

II The Canadian Constitution and International Economic Relations

The Canadian Constitution and International Economic Relations 57
Robert G. Richards

L'impact de l'internationalisation sur le fonctionnement de l'état: le partage constitutionnel des compétences 65
Ivan Bernier

Session II — Digest of Discussion 75

III Managing Economic Relations in a Federal State

Chairman's Remarks 79
Gordon Robertson

The Evolving Role of the Provinces in Canadian Trade Policy 81
Douglas M. Brown

An Alberta Perspective — Panel Remarks 129
Wayne Clifford

Une perspective québécoise: les commentaires d'un paneliste 133
Carl Grenier

The U.S. Perspective — Panel Remarks 139
Robert Herzstein

International Trade and the Management of Federal-Provincial Relations 147
David Barrows and Gordon Jansen

A British Columbia Perspective — Panel Remarks 151
Stuart Culbertson

Canada in the Global Context 157
Allan Gotlieb

Session III — Digest of Discussion 167

Le fédéralisme canadien et les relations économiques internationales 171
John Ciaccia

IV Developing Trade and Investment Strategies

Globalization: Lessons for Canadian Investment Policy and the Federation 183
Alan Nymark

Muddling Through is not Enough: A Survey of Global and Economic Challenges 197
Murray G. Smith

Trade and Investment Promotion in the United States: New Frontiers 239
Earl Fry

A British Columbia Perspective — Panel Remarks 257
Lorne Seitz

American Industrial Policy in the Early Years of the "Silent War" 265
James D. McNiven

Session IV — Digest of Discussion 279

V Canadian Federalism: Meeting the Challenges?

Concluding Comments 285
Richard Simeon

Session V — Digest of Discussion 293

Conference Participants 297

Foreword

As this volume appears, its themes are even more compelling than when the project was first conceived. The impact of the global economy on Canadian society, including our political system, is accelerating. The current economic recession facing Canada and other industrial countries, and such international economic events as the uncertain conclusion of the "Uruguay Round" of multilateral trade negotiations, pose significant challenges for Canadians. We are also faced with fundamental discontent with the political process and with our federal system of government. This climate of discontent is marked by the failure of the Meech Lake Accord and the resulting review in Quebec and elsewhere of the merits of the Canadian federation, the aboriginal issues raised by the crisis at Oka and elsewhere, and by widespread distrust and cynicism of incumbent governments and politics in general.

In this climate, it is important to encourage informed debate. That is the intent of this volume which consists of the proceedings of a conference held in March 1990 at Mont-Gabriel, Quebec entitled "Canadian Federalism: Global Economic Challenges." The interplay of global economic realities with the domestic debates about the political process within the federal system was the overall theme. The papers, commentaries and speeches published here indicate how broadly based are those debates. They include policy issues in trade relations, industrial strategy, macroeconomic policy, and labour, industrial and regional adjustment. A broad range of professional perspectives is also provided, ranging from academic and other independent analysis to government and industry practitioners in the fields of international trade and economic policy, economic development, constitutional law, and intergovernmental relations. We think that this collection provides fresh insights into the twin issues of the impact of economic "globalization," and how we get our act together in Canada as a federal political system.

The discussion of economic globalization at the conference revealed that Canada is being increasingly integrated into global markets for goods, services and capital. The Canada-United States Free Trade Agreement is accelerating this integration, but free trade is only part of a broader trend which we ignore at our peril. Canada has no choice but to be "open for business," and it seems that the quicker the adjustment to the international economy, the sooner will Canadians realize the full benefits.

The pace and nature of global economic change is nonetheless daunting, perhaps destabilizing. Canada faces global economic integration with a federal constitution and a regionalized economy. Any federal system obviously limits the degree of political integration achievable in Canada, but the federal system as currently constituted also presents important barriers to Canadian economic integration. The regionally differentiated economy contributes to the difficulty in adjusting to economic change. Several of the papers in this volume address specific aspects of the ability of the current federal system to respond to global trends, including the implementation of international economic commitments, and the best means of pursuing a competitive strategy for trade and investment promotion.

All of these discussions have been affected by the intense debate about the future of the Canadian federation itself. This volume outlines the many ways, both obvious and subtle, in which global economic trends have influenced our constitutional "discord." Since the conference at Mont-Gabriel in March 1990, the Meech Lake Accord debate has come to an acrimonious end, and the failure to pass the Accord has set the stage for a more comprehensive and fundamental questioning of the constitutional order, not only in Quebec but also across the country. There are many indications that Canada's integration within the global economy is having an influence upon the process of rethinking our constitutional values and institutions. There are, however, a great many other individual, regional and national objectives and values to be reconciled in a process of constitutional revision. The lesson from this conference would appear to be that improved political processes will be an important part of Canada's ability to respond to global economic challenges. Canada's success in meeting the global economic challenge without compromising social goals and fundamental values may therefore depend on how soon and how effectively we address our underlying constitutional problems.

Rod Dobell
President
Institute for Research
on Public Policy

Ronald L. Watts
Director
Institute of Intergovernmental
Relations

January 1991

Avant-propos

La mondialisation de l'économie fait sentir chaque jour davantage ses effets sur la société canadienne et partant, sur notre système politique. Confrontés à la récession économique déjà en cours qui affecte non seulement le Canada mais aussi les autres pays industrialisés, les Canadiens doivent supporter aussi les retombées d'événements économiques d'envergure internationale tel que l'Uruguay Round, particulièrement en ce qui touche l'issue des négociations commerciales de type multilatéral qui s'y déroulent. Dans le même temps, on observe au Canada un malaise profond aux niveaux des mécanismes politiques et du système fédéral de gouvernement: en font foi, par exemple, l'échec de l'Accord du lac Meech et la réévaluation subséquente, au Québec et ailleurs au Canada, du cadre fédéral canadien, la problématique autochtone exacerbée lors de la crise d'Oka et la méfiance de même que le cynisme partagés par un grand nombre de Canadiens à l'endroit de leurs gouvernements et de la politique en général.

Le présent volume a pour but d'éclairer certaines de ces questions. En fait, le lecteur y trouvera les actes d'un colloque qui s'est tenu en mars 1990 à Mont-Gabriel, au Québec, et qui s'intitulait "Le fédéralisme canadien: à l'épreuve du défi économique mondial". Le thème général du colloque fut consacré à l'influence exercée par la réalité économique mondiale sur les discussions actuelles à propos du fonctionnement des mécanismes politiques de notre fédération. Toutefois, les articles, commentaires et discours publiés dans ce volume embrassent également des dossiers gouvernementaux spécifiques tels que la politique commerciale, la stratégie industrielle, la politique macroéconomique, la politique en matière de main d'oeuvre, la politique régionale et d'ajustement industriel. Les participants au colloque provenaient de divers horizons: outre les universitaires et les analystes indépendants, on comptait des praticiens industriels oeuvrant dans les secteurs du commerce international et des politiques économiques, du développement économique, du droit constitutionnel et des relations intergouvernementales. Comme tel, nous estimons que cet assemblage fournit un aperçu nouveau des deux enjeux suivants qui nous apparaissent intimement liés, soit en l'occurrence: a) l'impact de la mondialisation des échanges sur l'économie canadienne et b) la manière de "reprendre en main" le Canada en tant qu'Etat fédéral.

La discussion autour de l'internationalisation des échanges a montré que l'économie canadienne fait l'objet d'une intégration de plus en plus croissante au sein des marchés mondiaux des biens, des services et du capital. A cet égard, l'Accord de libre-échange entre le Canada et les Etats-Unis, du fait qu'il participe nettement de ce phénomène, reflète bien aussi sur un plan régional cette tendance mondiale incontournable. En vérité, le Canada est "condamné" à élargir son aire commerciale: le plus vite il s'ajustera aux impératifs de l'économie internationale, le plus tôt les Canadiens en apprécieront tous les bienfaits.

Or, la transformation économique qui s'opère sur le plan mondial n'est pas sans susciter certaines craintes en raison du rythme et du type même des changements en cours. Le Canada doit, en effet, parvenir à une intégration poussée de son économie au marché mondial mais, pour ce faire, il doit composer avec une économie fortement continentalisée au départ ainsi qu'avec les tensions inhérentes à son propre système politique fédéral. Il est patent que la structure fédérative rend plus complexe la réalisation d'une pleine intégration politique au Canada; aussi en va-t-il de même avec l'économie canadienne qui, de par sa nature régionale, nécessite un ajustement substantiel afin de s'ouvrir à de nouveaux marchés.

Plusieurs des articles dans ce volume traitent, de manière ponctuelle, de l'aptitude du système fédéral à réagir aux tendances mondiales de l'économie, le tout se traduisant par la mise en oeuvre d'ententes économiques sur le plan international et le maintien d'une stratégie efficace d'accroissement des échanges et de l'investissement. Le débat intense qui a lieu présentement sur l'avenir constitutionnel du Canada déterminera l'issue des discussions rapportées dans ce volume. Celui-ci indique comment au juste le contexte économique international a pu influer sur le désaccord constitutionnel canadien. Suite au colloque tenu à Mont-Gabriel en mars 1990, le débat sur l'Accord du lac Meech s'est fatalement envenimé lors de son dénouement. L'incapacité de ratifier l'Accord oblige maintenant à un questionnement en profondeur du présent ordre constitutionnel, non seulement au Québec mais également à travers le pays. Il appert aussi que le processus en cours visant à redéfinir nos institutions et valeurs sur le plan constitutionnel s'avère conditionné en partie par le phénomène actuel de l'expansibilité de l'économie canadienne. On compte cependant maints autres objectifs et priorités aux niveaux individuel, régional et national qui devraient être également pris en compte dans le processus constitutionnel. S'il est une leçon à tirer de ce colloque, c'est que le Canada devra apporter de sérieux correctifs à son processus politique s'il entend relever efficacement les défis économiques qui se posent au niveau mondial. La réussite du Canada en cette matière — en accord avec nos objectifs sociaux et valeurs essentielles — dépendra en grande partie de la célérité avec laquelle nous aborderons les problèmes constitutionnels de ce pays.

Rod Dobell
Le président
L'Institut de
recherches politiques

Ronald L. Watts
le directeur
L'Institut des relations
intergouvernementales

janvier 1991

Acknowledgments

Both the conference "Canadian Federalism: Global Economic Challenges" and this book have been sponsored by the following generous contributors: The Government of Canada: External Affairs and International Trade, Investment Canada and Industry, Science and Technology, Canada; the Government of Quebec: Ministère des affaires internationales; the Government of Alberta: Department of Federal and Intergovernmental Affairs; the Government of Ontario: Ministries of Intergovernmental Affairs and Industry, Trade and Technology; the Government of British Columbia: Ministry of International Business and Immigration; and the Government of Saskatchewan: Department of Trade and Investment. The Institute of Intergovernmental Relations also wishes to acknowledge the Power Corporation, the Donner Canadian Foundation (Queen's Canada-United States Project) and INCO whose support facilitated the planning of this project.

The organizers of the conference and the editors of this volume would like to acknowledge the time and effort of all of the contributors, including the session chairpersons. The conference logistics were ably orchestrated by Lynda Lennon of the IRPP, assisted by Don Wilson, Maria Grandinetti, Melanie Burston and Louise Gervais and the team of translators from Translex.

For the preparation of the proceedings at the Institute of Intergovernmental Relations we would like to acknowledge the assistance of Dwight Herperger and Donald Padget. The text preparation has been professionally completed by Valerie Jarus and Darrel Reid. Daniel Bonin assisted with french translation, and Patti Candido with cheerful administration.

Douglas M. Brown and Murray G. Smith

Introduction

Introduction

Douglas M. Brown and Murray G. Smith

The global economic challenges facing Canada include long-term trends and more immediate pressures which are changing the conditions of economic and political life in this country. These economic challenges are reflected in the ever increasing movement of goods, services, capital, and even labour across national borders, on a scale that is unprecedented in human history. These changes are being driven by technological developments, by the emergence of multicontinental transnational corporations and by various trading initiatives including Europe's 1992 agenda and Mexico's free trade initiative. The pace of global economic change has accelerated during the 1980s and seems destined to sustain a rapid pace throughout the 1990s and into the twenty-first century.

Although all states face challenges in the last decade of the millenium, the external economic challenges for Canadian governments and the Canadian federation are particularly acute for several reasons. First, as is widely recognized, the Canadian economy depends directly upon international commerce for about 30 percent of national income, which is much higher than in large economies such as the United States or Japan. Second, and much less commonly acknowledged, the Canadian economy has a substantial burden of foreign debt. Rapidly approaching $250 billion, Canada's net international liabilities exceed those of any of the Latin American debtor nations and on a per capita basis Canada's international liabilities exceed those of any nation. Third, Canada has a substantial current account deficit running at about 3 percent of Gross National Product (GNP). Servicing these international liabilities and reducing the current account deficit during the 1990s will require dramatic shifts in the pattern of Canada's external trade with far reaching implications for the Canadian economy. The income and wealth of every Canadian is dependent upon Canada's performance in international commerce and the expansion of exports of goods and services will be the key to Canada's economic growth in the 1990s.

External economic challenges generate political challenges. Internationally, political developments helped to create the conditions for the globalization of the economy, and continue to do so. One has only to consider the events of the past year in Eastern Europe. Closer to home the political challenges for Canada consist of making public policy choices for the many difficult problems and opportunities that the globalization of the economy presents. These include, among others, issues in trade and industrial policy, macroeconomic policy, labour and community adjustment, educational, and research and development policies. A specific political challenge also arises in the effect of economic globalization on existing institutions and processes of political integration. In Canada, this means primarily our federal system of government.

The issues of international economic relations have played a prominent role in public debate in Canada over the past few years. The intense debate over the Canada-United States Free Trade Agreement is only the most prominent and most recent of many such issues. The 1911 election debate over the Reciprocity Treaty was highly charged and the Canadian tariff has been for many years a focal point of regional grievance outside central Canada.[1] Some of the issues under negotiation in the "Uruguay Round" of negotiations under the auspices of the General Agreement on Trade and Tariffs (GATT), such as proposals to liberalize or to eliminate the restrictive quotas that Canada and other countries impose in sectors such as dairy and textile products could provoke intense opposition from interest groups and be the subject of regional tensions within Canada.

Canadians have also gone through a divisive debate on constitutional reform and values, surrounding the Meech Lake Accord. The demise of the Accord in June 1990 has had the effect not of ending debate, but of intensifying and broadening it to include a more fundamental questioning of the existing federal system and other alternatives for sharing sovereignty in what is now Canada. Some political analysts[2] have argued that tensions which were generated by the debate over the Free Trade Agreement contributed to the opposition to the Meech Lake Accord. Many Canadians outside Quebec in particular opposed both the FTA and the Accord on similar grounds as eroding the basis for Canadian autonomy by reducing the authority and manoeuvrability of the federal government. Domestic adjustments to changes in the international economy, given the difficult fiscal and economic circumstances of the past few years, have also contributed to a heightened sense of insecurity and irritability (if not intolerance) on issues concerning national reconciliation.

Therefore, changing circumstances in the global economy are creating pressures for change in Canadian public policies and are a factor contributing to recent challenges to Canadian political integration. But there is another side to this coin. The Canadian federal system, with its system of complex intergovernmental relations shapes how the policies of Canadian governments and the regional economies of Canada respond to the challenges of the global economy. This response includes ensuring that the conduct of trade negotiations and the management of Canada's international economic relations take into account diverse regional interests. Meeting our evolving international obligations within the confines of Canada's complex and imprecise jurisdictional divisions of power between federal and provincial governments can be a source of intergovernmental and interregional tension within Canada and can create difficulties with our trading partners. At the same time, however, the negotiation of international trade agreements and the interpretation of international trading rules provide opportunities to resolve longstanding internal Canadian issues such as interprovincial barriers to trade and commerce.

This volume is addressed to the interaction of two systems: the global economy and Canadian federalism. Together the contributions to the volume address the effects of the global economic challenges on Canadian federalism, and show how the federal system affects the Canadian response to global challenges. It comprises papers, speeches, commentaries and discussions of a conference jointly organized by the Institute for Research on Public Policy and the Institute of Intergovernmental Relations, held at Mont-Gabriel, Quebec, 29-30 March 1990.

The intent of the conference was to present, through original research and independent analysis, fresh perspectives on the dimensions of the global economic challenge and Canadian federalism. The conference also brought together a unique blend of senior government officials, academic and other researchers and private sector representatives. The mixture resulted in a fascinating chemistry with diverse and productive discussions. This volume makes the results of the conference available to a broader audience. In the editors' view, the themes discussed in March 1990 are even more pressing in early 1991 as this book goes to print.

The papers are an eclectic mix prepared by academic researchers, commentaries from experienced public policy managers, and thought-provoking statements from foreign and domestic policy observers and practitioners. They cover a very broad territory. While the focus of the conference was on the global economic challenge in terms of trade policy and trade development, various contributors addressed related topics including macroeconomic policy, industrial strategy, and investment and competition policy. Perspectives on the global challenge were provided from the United States and the European Community. Developments in Japan, Mexico and Eastern Europe were also discussed.

Canada's response to these developments was subjected to analysis from many disciplines including economics, intergovernmental relations, constitutional and trade law, foreign affairs, business behaviour and political science.

Since the conference, a number of internal and external events have shaped how Canadians will respond to these themes. The constitutional agreement of 1987, called the Meech Lake Accord, failed to attain the required legislative approvals within the three-year time frame to be ratified. This event has precipated a broader crisis in the future of Canadian federalism, particularly in Quebec. A highly publicized confrontation between Canadian authorities and Mohawk Warriors in Quebec, and related conflict elsewhere in Canada, also challenged the stability of the political status quo. A more widespread malaise in political consensus-building has been manifest in the low approval ratings of incumbent governments and in high profile parliamentary disputes such as that in the Senate over the Goods and Services Tax. The international scene has also evolved rapidly: time has just about expired on the Uruguay Round, Mexico has launched a major free trade initiative, and the war in the Persian Gulf is having unpredictable consequences for the global economy. In spite of these changes, the basic themes of the conference, as well as many of the nuances of the various perspectives presented, remain highly relevant to the choices Canada now faces. Indeed, the discussion here may help Canadians to better understand subsequent events and to illuminate events yet to come.

On a final introductory note, papers as they appear in this volume are in their order of appearance at the conference. For the remainder of this introduction, however, reference will be made to individual papers not necessarily in the order they appear in the text, but on their relevance to a number of key themes which we the editors, have drawn from the conference proceedings. We begin by highlighting briefly some of the external economic challenges, and then turn to the policy responses of Canada's major trading partners. Canada's place in this global context is identified by the next theme, followed by the impact of this global context on the federal system. The last two sections of this chapter address the opportunities and constraints imposed by the federal system, and the issues for effective economic and political integration posed by Canada's uncertain constitutional future.

Global Economic Challenges

This theme of "global economic challenges" was also the theme of the first session of the conference dealing with an overview of "Canada and the Global Economy" (Part I of this volume). The dimensions of economic globalization were introduced by the chair of the first session, Germain Denis, currently leading Canada's team in the Multilateral Trade Negotiations. He argues that globalization presents both opportunities and risks for Canada. The opportunities come from an expanded world of trade and investment prospects; the risks lie in adjustment at home and protectionism abroad. These same themes of the opportunities and risks are evoked by André Sapir, of the Free University of Brussels, who examines the potential linkage between the negotiating agenda in the Uruguay Round and Europe's 1992 agenda.

Expanded trade is not the only phenomenon of globalization. Global markets for finance and investment have also become a reality. Alan Nymark, of Investment Canada (Part IV), examines the rapid expansion of foreign direct investment among the industrial economies, the recent boom in mergers and acquisitions and the growing importance of international business linkages and strategic alliances, which in his view are redefining the basis for economic interdependence and have implications which Canadian policy-makers are only beginning to understand. Thus economic integration in the "real" economy (e.g., trade in goods and property) must adjust to an even greater integration occurring in the "symbol" economy (i.e., financial markets and investment patterns).

The domestic impact of growing international competition is also reviewed by Murray Smith of the Institute for Research on Public Policy whose chapter (Part IV) analyses the continuing debate in Canada about the proper role of government in the market, and the debate about pressures for international harmonization in public policy such as regulation and taxation. Although globalization does impose constraints upon government policies, in his view the Canadian debate about harmonization and free trade misunderstands these pressures. Relatively lower income and corporate tax rates in the United States will attract emigration of highly-skilled individuals and firms from Canada whether or not there is free trade. Smith argues that the longer term economic gains from free trade offer Canadian governments the ability to increase tax effort modestly, and that the real challenges to Canadian policies come from Japan and the Asian NIEs (Newly Industrialized Economies) which have high savings and investment rates, low tax shares of GNP and high rates of economic growth. Canadian efforts to restrict emigration are politically unacceptable and restrictions on imports are very costly, but Canada also must take account of the political developments in its trading partners.

Political Responses by Canada's Trading Partners

Closely linked to the external economic challenges are policy responses by the United States, the European Community or Japan, all of which have profound consequences for the Canadian economy and political system. It matters greatly to Canada that our exposure to the global economy comes principally through our trade and investment links with the United States — although the effects of policies in Japan and the European Community are also important. Robert Herzstein, a senior Washington trade lawyer, reviews (Part II) the recent focus in the United States on "structural impediments" to trade, including business behaviour and political, social and cultural organization of U.S. trading partners. The primary focus of U.S. concern is economic tensions in bilateral relations with Japan, but the redefinition of the international economic agenda in the United States will have broader repercussions. Such trends will inevitably affect Canada's bilateral trade relations not only with the United States, but also with other major trading partners which Canada and the United States share.

Yet another way of approaching the globalization issue is through the differential impact it is having on major economic players. Many Canadians have been struck by the example of the European Community's drive towards more complete economic integration by 1992. The prospects for this project are reviewed in the chapter by André Sapir. (Part I). The critical issue of whether Europe will be more outwardly or inwardly focused still hangs in the balance, but the issues relating to integration and the EC's political processes for achieving agreement are of interest to Canadians. As for the United States, Allan Gotlieb, former Canadian Ambassador to the United States (Part III) warns Canadians not to underestimate the U.S. ability for economic resurgence despite cyclical retrenchment. The United States may be experiencing economic decline in relation to its unquestioned hegemony of 40 years ago, but in absolute terms, according to Gotlieb, it is still a formidable power. Partly in reaction to the relative decline, however, United States foreign policy has emphasized economic interests in recent years — a lesson Canadians learned to their dismay in the lumber dispute of 1986-87 when powerful domestic economic interests in the U.S. threatened to severely damage overall foreign relations with Canada.

Other broader trends in U.S. trade policy are also delineated in comments by Robert Herzstein (Part III), and in papers by Murray Smith, Earl Fry of Brigham Young University and James McNiven of Dalhousie University (Part IV). These trends include an important domestic debate over industrial strategy. Proponents of a more proactive approach by governments towards high-tech industries in particular, are gaining an increased hearing in the United States. It is the U.S. state governments that continue to lead the way, however, in innovative export trade and investment expansion measures, although often in ways that distort trade and reduce the overall American commitment to a liberal trading regime. Canadians need to be especially aware of U.S. initiatives related to Japan (i.e., the debate about managed trade versus free trade) and to Mexico (free trade area negotiations). Neither of the latter issues are the dominant focus of individual chapters, but are addressed to some degree by Gotlieb, McNiven, and Smith.

Apart from responding to the general trends and major players just described, where does Canada fit into the pattern of the global economy? One conclusion reached by a number of commentators is that Canada can no longer rely on its status as a middle power in a multilateral trade regime. Protectionism and managed trade among the three big emerging trading blocks (North America, Europe and Asia-Pacific) will drive Canada even further into economic integration with the United States. This is a scenario posited by Allan Gotlieb among others. As a partial antidote to this view, Jake Warren, trade advisor to the Government of Quebec, notes that in the current Uruguay Round of multilateral trade negotiations, it is groups of smaller countries, including Canada, which were playing the more active role. Should the Uruguay Round not succeed, however, the multilateral regime may not fully recover, and Canada will have no choice but to rely upon the regional trading relationship. Current trends indicate that, even if the large regional trading blocks do not behave in a protectionist manner, the Free Trade Agreement (FTA) with the United States will dominate Canada's role in the global economy. The challenge of adjustment to the FTA in its first year or so is underlined by several commentators, including John Ciaccia, Quebec's Minister of International Affairs (Part III), and Tom Courchene of Queen's University. The latter addresses in particular the current difficult climate for Canadian firms given the appreciation of the Canadian dollar and high interest rates. Courchene argues in favour of a more decentralized fiscal policy in Canada with, for example, provincial governments taking fiscal initiatives to ease the pressure for a strong federal monetary policy response to inflation. He also argues for Canada-U.S. exchange to be more closely linked to ease adjustment to the FTA created by an overvalued Canadian dollar. Issues such as the continuing subsidies negotiations are also addressed by several commentators, such as Murray Smith, Earl Fry (with respect to U.S. practice) and Robert Herzstein. The subsidy debate is likely to continue on both sides of the border with an emphasis on how far trade policy should or can go to limit the ability of governments at all levels to intervene in their respective national and regional (and even local) economies.

Global Impacts on the Federal System in Canada

This raises the second major theme of the conference, Canadian federalism. This theme was the focus of the second session "The Canadian Constitution and International Economic Relations" (Part II) and the third session "Managing Economic Relations in a Federal State" (Part III).

One of the chief political consequences of globalization is the increased blurring of distinctions between the domestic and foreign economies, especially in terms of economic regulation. This means that trade policy matters have come to embrace not only national regulations such as tariffs, but also the whole range of non tariff barriers as well. The fact that non tariff barriers in Canada are as frequently imposed by provincial governments as by the federal government is a significantly complicating factor.

In the session on constitutional law, Robert Richards of the Saskatchewan Department of Justice, and Ivan Bernier of Université Laval, address trends in constitutional law affecting Canada's ability to conduct international economic relations. Richards reviews the state of jurisprudence affecting treaty-making and implementation, and the federal Trade and Commerce power. Unlike other federal systems such as Australia or the United States, Canada's constitution does not grant the federal government the right to override provincial legislation in order to implement an international agreement. Thus Richards concludes that treaties reached by the federal government can still only be implemented in areas of provincial jurisdiction with the cooperation of the provinces. In addition, in Canada, the federal Trade and Commerce power has for a century been interpreted narrowly to allow considerable leeway for provincial jurisdiction over business practices and intra-provincial trade. Recently, however, a series of judgements have been leading the way to a broader interpretation of a general use of the Trade and Commerce power, where a national regulatory scheme is contemplated. Such legal trends could have far-reaching consequences for Canada's future ability to conduct international economic relations.

Such legal developments will not be sufficient, however, to affect many of the constitutional levers of the provincial governments, and their implication for international trade in the current age of "non tariff barriers." Bernier therefore focuses on both judicial and non-judicial means of solving current jurisdictional difficulties. On the former front, he advocates that jurists adopt a set of interpretive rules which distinguish between provincial measures that are discriminatory (which would in his scheme, be unconstitutional), and those measures that were non-discriminatory (therefore constitutionally valid). In the meantime, and where such legal interpretation is not helpful, Bernier argues that governments in Canada must return to the more pragmatic use of collaborative mechanisms in order to undertake coordinated trade policy.

The recent history of such collaborative mechanisms was the focus of the chapter by Douglas Brown of the Institute of Intergovernmental Relations. Trade relations have always been a matter of regional tension in Canada, but in more recent years the provincial governments through the mechanisms of "executive federalism" have come to represent more directly regional interests in national trade policy. At the same time, international trade disputes have often focused on provincial practice. The issue of subnational compliance with the GATT rules has been raised more frequently with respect to Canada than for any other country. Add to this the jurisdictional uncertainty of how far non tariff barriers and new agreements on trade in services reach into provincial law, and one has the prerequisites for extensive provincial collaboration in trade policy-making in Canada.

Finally, both Richard Simeon and Tom Courchene contend that one of the chief losers of globalization is the federal government, losing power in two directions: above to supranational organizations (e.g., the GATT, and the Free Trade Agreement), and below to individuals, corporations and cities (through which the business of economic globalization occurs). Thus these issues of sovereignty, harmonization, "structural impediments," regulation and intervention are all important elements of the impact of economic globalization on the political agenda.

Canadian Federalism: Constraints and Opportunities

Whether such constitutional and institutional considerations represent constraints or opportunities for Canada in meeting the global challenge depends in part on where one sits. Clearly from the perspective of the federal government, charged with conducting foreign trade policy, the constitutional provisions are constraining. It may only be in the detail of individual policy processes and outcomes that a complete judgement may be formed, however. In this respect, much of the discussion, which took place in the third session of the conference (Part III) and in other sessions, deals with the recent role of federal-provincial relations in trade policy and negotiations. Douglas Brown provides an evaluation of how the role of the provinces in trade policy has evolved to what he calls a "partnering" relationship with the federal government. This evolved role led to intensive involvement of the provinces in recent trade relations, as in the dispute with the European Community over provincial liquor board practices, and the resolution of the softwood lumber dispute and the bilateral trade negotiations with the United States. According to Brown, such intensive collaboration did not extend in most cases to joint decision-making among the federal and provincial governments. However, detailed consultation with the provinces has become an essential ingredient to achieving trade policy in Canada.

The ensuing discussion of this topic includes commentaries by Wayne Clifford of the Government of Alberta, Carl Grenier of the Government of Quebec, David Barrows of Ontario, Robert Herzstein and Alan Nymark, among others. Issues raised include the problem of reaching binding commitments with the provinces, whether or not to formalize the process of consulting provinces, how to define provincial interest, and evaluating the costs of consultation in terms of time and effort involved. The consensus appears to be that the intensive intergovernmental consultations over trade policy were worth the complexity required, and that in any case it was the only feasible way of managing trade relations in the current federal system. Nonetheless, an absorbing debate over the weaknesses of the federal way of doing things emerges in discussion of the controversial softwood lumber case, where division among provinces detracted from an effective Canadian case (see comments by Brown, Clifford, Grenier, Herzstein, Gotlieb, and Ciaccia in Part III, and the digest of the discussion in part III and part IV).

The recent experience with executive federalism in trade policy can be characterized in contrasting ways. It is clear that provinces have acquired a significant role in the development of Canadian trade policy which was previously a sole perogative of the federal government. Nonetheless, while the federal government has consulted intensively with the provinces during the free trade negotiations with the United States and during the Uruguay Round of GATT negotiations now underway, the federal government not only exercised its constitutional authority and responsibilities with the implementation of the Canada-U.S. Free Trade Agreement, it can be argued that it actually extended the scope of federal jurisdiction. This latter contention is based on the fact that the federal parliament passed without legal challenge the Canada-U.S. Free Trade Agreement implementation legislation, which provided for its imposition on the provinces in the last resort. A reply to this argument may be that such a challenge may yet be mounted and that in any case the FTA, which in the end involved provincial jurisdiction so modestly, is not the best test of this principle.

Although the process of intensive federal-provincial consultation has been cumbersome, this executive federalism has worked for international trade disputes and negotiations. For example, the provinces adopted varying approaches to the implementation of the FTA. Quebec exercised its sovereignty by passing an implementing order-in-council, while other provinces have tacitly accepted their obligations. This pragmatic approach may not be as feasible in the post-Meech Lake environment. Depending on the outcome of the Uruguay Round, the boundaries of federal and provincial jurisdiction could be tested much more rigorously than with the implementation of the Canada-U.S. Free Trade Agreement. A successful outcome in the Uruguay Round may require explicit provincial concurrence on a number of issues. In particular, provincial participation in an expanded GATT procurement agreement, provincial commitments on agricultural and industrial subsidies, and provincial compliance with new rules on services and investment-related performance requirements could be essential to achieving Canadian objectives in the Uruguay Round negotiations.

Thus, the Uruguay Round could provide a significant forum for either conflict or cooperation in federal-provincial relations over trade policy. If the provinces are seen as not complying in the implementation of a multilateral trade agreement reached by Canada, the jurisdictional issue could land in the courts, with potentially significant legal consequences. In any case, Canada's trade partners are unlikely to leave much to chance, so even a cooperative implementation in Canada will require clear, precise and substantial federal-provincial concurrence.

Another area where the federal system has had a significant impact has been in trade and investment promotion. Both Canada and the United States have taken a more decentralized approach. In an era of "fend for yourself" federalism in the United States, the state governments lead the way according to Earl Fry. The result is a great variety of ingenious means to attract and retain investment and to stimulate exports. In Canada, too, a provincially-led effort of proactive and directed trade and investment promotion makes more sense, according to Lorne Seitz, of the Government of British Columbia (Part IV). Seitz also raises the role of immigration as a way to foster international business and cultural relationships, particularly with the Asia-Pacific region. It is evident that individual provincial governments have different priorities for their domestic economies and take different approaches to trade and investment promotion.

Canadian Federalism: An Uncertain Future

The issue of whether Canada's federal system is a constraint or an opportunity is indeed apt now that the future of Canadian federalism and the federation itself is so uncertain. The issue is not simply centralization versus decentralization in government structures. Both nations with highly centralized governmental structures, such as Japan, and highly decentralized federal systems, such as Switzerland, have enjoyed economic success. What matters is the overall climate for investment and private sector activity which is shaped by governmental policies. Where diversity of response is an asset, the federal system can deliver better results. This is a point stressed by both Tom Courchene (especially with regard to provincial financial regulation and fiscal policy), and Richard Simeon. Conference commentators also point to the flexibility and adaptability of Canadian federalism over time. Diversity, flexibility and adaptability are clearly advantages in responding to the changing global challenge. Nonetheless, fragmentation, discord and lack of coordination are disadvantages. To the extent that a federal system of government encourages the latter characteristics, the benefits of the former can be lost. In such cases the overall effect could be damaging to Canadians not only in terms of their economic unity, but also in terms of the attractiveness of the Canadian economy to investors. The contributors to this volume do not attempt to make any general conclusions as to whether Canadian diversity is on balance good or bad in meeting the global challenge. Suffice it to say that the diversity exists and must be managed.

Some general lessons about Canada's role in the global economy are summarized by Alan Nymark: Canada has no choice but to be "open for business." This requires an emphasis on investment and technology as much as it does on trade, and a domestic commitment to industrial restructuring and adjustment. Against these challenges, however, Richard Simeon, of Queen's University, presents yet another, more uniquely Canadian effect of economic globalization (part V). The Canadian economy, already fragmented regionally, is becoming less and less integrated on a national basis. Simeon reminds us that east-west integration is, with the FTA and other trends, giving way to north-south integration. Not only does this trend render more difficult national policy-making for restructuring and adjustment, but also it erodes the economic underpinnings of political integration. If Ottawa is becoming less and less effective at mediating global economic trends, will it become less and less relevant to Canadians?

In relation to Simeon's point, Smith argues that east-west integration must not be forced, since forced integration through Canada's own international trade barriers make the nation poorer and have often been the focus of regional grievance. In Smith's view the mounting federal debt and the continuing federal deficit are much more debilitating to the ability of Canadians to provide some mutual protection against the vagaries of the world economy. At the same time, Smith argues that internal barriers within Canada do gnaw at the fibres of nationhood, because they reduce national income and because they undermine internal economic links.

As noted, the discussion of the costs and benefits of integration or disintegration at Mont-Gabriel took place under the singular cloud of uncertainty about the fate of the Meech Lake Accord. Several commentators noted that their assessments of the way in which the Canadian federal system responded to the global economic challenge could only be tentative in light of the then unknown fate of the Accord. The post-Meech era in Canadian public life is already characterized by a questioning of the fundamental political values and structures by which we live. The end result is most unlikely to resemble the status quo, and much more likely to accelerate the trends to political disintegration and decentralization. As John Ciaccia stated in his address to the conference:

> The challenge facing federal states is not to ignore or deny the existence of nationalistic feelings within their boundaries but to channel their energies into federalism and by so doing strengthen the federal state.

More recently, Quebec nationalists appearing before the Parliamentary Commission on Quebec's Constitutional and Political Future (Belanger-Campeau) argue that Quebec alone could do a better job in meeting the challenges of the fiscal deficit, industrial restructuring and global competitiveness, than it has been doing within the Canadian federation. Counter to these arguments are those marshalled by federalists and other observers who argue that the potential disintegration of economic unity which greater political autonomy for Quebec could bring, would negate any advantages of autonomy in terms of responding to the global economic challenge.

Emerging from the discussion of this volume there are therefore a number of points which bear emphasizing as they have a significant bearing on the continuing constitutional debate in Canada. The first is the point which Richard Simeon makes in his concluding remarks, that a federal system of government affects not only domestic policy, but the entire impact of a country in the global context. This is true now and for any successor arrangements — our internal ordering will affect integrally our international relations. The speech by John Ciaccia demonstrated a long history of Quebec involvement in the international arena, which foreshadows the continuation of a diverse set of messages from Canada abroad. Similarly, as Germain Denis points out, trade negotiators are constantly redefining the exercise of sovereignty by accepting constraints (and this is equally true of international relations in a host of other areas). The need to do so increases with accelerating economic globalization. A sovereign Quebec would only have to immediately cede much of that sovereignty to institutions of economic and political integration necessary to survival in the global economy. This almost certainly would mean a free trade agreement with the United States and participation in the GATT, but also and perhaps with even greater urgency, arrangements for economic integration with the rest of Canada. It must be remembered that the current Canadian customs union retains some significant international trade barriers such as import quotas on dairy products and textiles, and that the current Canadian economic union is much more comprehensive than the Canada-U.S. FTA.

The discussion on interprovincial trade barriers (Part IV) brings forward another continuing issue: preserving or extending the economic union among the existing and successor political units in any new constitutional order will be another priority of many diverse political and economic interests both inside and outside Quebec. Recent efforts within Canada to reduce barriers may finally be bearing fruit. The urgency and importance of these efforts will increase as new political structures are contemplated in the "post-Meech" period.

Among these new structures, and the realm of possible options, Canadians and Quebecers will thus be asking themselves the question of what sort of political integration is required to accompany the desired level of economic integration. Implicit in how many Canadians have viewed recent Canadian responses to the global economic challenges, is the assumption that a more unitary political system (whether as Canada or as Quebec) would deliver a more coherent response.

On the other hand, decentralized political institutions can work for certain purposes. The Free Trade Agreement has been launched with only the most elementary of joint institutions, although as is argued about federal-provincial arrangements, more intense consultation between the Canadian and U.S. governments *may* resolve some differences without more formal institutional frame works. Nonetheless, it seems more likely that Canadians will opt for a more integrative political model, in which case the focus will be on what levers must essentially be in the hands of a central government, even if that government is only a delegated authority of five or ten strong regional governments, or a superstructure created by the national entities of Quebec and the "Rest-of-Canada." The example of the European Community and the types of political institutions it is adopting will be of significant interest in the domestic Canadian debate.

In the closing discussion, André Sapir compares Canada to Belgium as well as the European Community. Belgium has similar linguistic cleavages and is even more dependent upon "external" trade than Canada. Yet much of Belgium's trade is with EC countries. The European Community is a much more comprehensive vehicle for economic integration than anything contemplated in the Canada-U.S. FTA.

There are positive and negative lessons for Canada from the European Community. Indeed after 1992, the European Community will have a much more open internal market than does Canada. Yet the Community has a much less developed basis for political integration than now exists in Canada. In particular, the Community has a Byzantine decision-making structure for international economic relations. Large trading powers such as the European Community or the United States are much better able to survive unwieldy decision-making structures for international economic relations than are more modest trading powers such as Canada.

One of the gains from the current federation in Canada which is often overlooked, is the conduct of trade diplomacy. Whether it is dealing with trade disputes under the FTA and the GATT, completing the Uruguay Round of GATT negotiations or coping with the fall-out if the Round fails, negotiating trade rules with the United States under the Canada-U.S. FTA, negotiating with Mexico and the United States regarding a possible trilateral FTA, dealing with Europe after 1992, or responding to Pacific or Latin American initiatives, a united Canada will have more clout — however modest that may be — than a fragmented entity or entities in advancing the economic interests and securing the livelihood of Canadians.

* * *

To conclude, even with considerable institutional change, the underlying economic interests of Canadians will not change significantly — or at least not in ways much different from the trends identified here. Thus, the globalization of business, even if it is within a political frame work shaped by powerful trading blocks, means that Canadians must continue to adjust to an open and competitive environment if they are to prosper. Many of the economic issues dominant in current domestic intergovernmental relations will continue to prevail. These include regional and labour adjustment, trade policy implementation, and trade and investment promotion. Competing regional interests will need to be accommodated, as will competing models for industrial restructuring and adjustment. The requirements of consultation and collaboration reviewed by Simeon will therefore remain, whatever the new institutional arrangements.

The task of improving our institutions of political integration, and thereby improving our level of economic integration both at home, and within the global economy, is vital. Without effective processes for arriving at consensus, we cannot hope to improve our response to the global economic challenge. Therefore this task should not wait on a long constitutional debate. At the same time, if Canadians become more aware of global challenges and explore cooperative responses, they could become less preoccupied with regional grievances and constitutional differences.

For the participants at the conference at Mont-Gabriel at least, the challenge is here and now. The global economy does not roll with every squall on Meech Lake. Canadians will ignore this reality to their peril.

NOTES

1. For example, W.A. Mackintosh's seminal study of the Canadian tariff, which was undertaken for the Rowell Sirois Commission documented these regional tensions 50 years ago. See *The Economic Background of Dominion-Provincial Relations*, 1939, (Toronto: Macmillan, 1978). Of course, the Rowell Sirois Commission was itself a response to the stresses on the Canadian federation arising from the Great Depression.
2. See, for example, Roger Gibbins, "Canadian Federalism: The Entanglement of Meech Lake and the Free Trade Agreement," *Publius* vol 19, 3 (Summer 1989): 185-198; and Peter M. Leslie, "The Peripheral Predicament: Federalism and Continentalism," in P.M. Leslie and R.L. Watts (eds.), *Canada: The State of the Federation, 1987-88* (Kingston: Institute of Intergovernmental Relations, 1988), pp. 3-36.

I

Canada and the Global Economy

Discours d'ouverture

Roger Charbonneau

Au nom de l'Institut des relations intergouvernementales de l'Université Queen's et au nom de l'Institut de recherches politiques, j'ai le plaisir de vous souhaiter la bienvenue au présent colloque.

Les bouleversements politiques en Europe de l'Est ont récemment retenu notre attention. Au Canada, les problèmes constitutionnels sont au premier plan de l'ordre du jour politique. Mais à l'échelle mondiale, des développements économiques s'annoncent qui sont peut-être moins spectaculaires que les nouvelles quotidiennes, mais dont l'importance pour notre pays est pourtant, au moins, tout aussi grande. C'est pourquoi nous avons organisé le présent colloque. Notre symposium a pour thème les défis économiques qui se posent au Canada à l'échelle mondiale et les stratégies que les gouvernements canadiens doivent envisager pour y répondre individuellement ou collectivement.

Au cours de la première séance, nous examinerons les conséquences de l'évolution économique récente et prochaine de l'Europe, compte tenu particulièrement de l'échéance de 1992, sur les négociations multilatérales du GATT et quant aux perspectives qu'elles présentent pour le Canada. A la deuxième séance, nous étudierons le partage des pouvoirs entre le gouvernement fédéral et les gouvernements provinciaux, selon la Constitution canadienne et à la lumière de la jurisprudence créée par la Cour suprême du Canada. Et nous poserons la question d'une nouvelle répartition possible de ces pouvoirs.

Cet après-midi, nous nous pencherons sur les expériences canadiennes récentes quant à la gestion de nos relations économiques internationales et sur l'évolution de notre système fédéraliste à ce sujet. Enfin, ce soir, j'aurai le plaisir de vous présenter Monsieur John Ciaccia, le Ministre des affaires internationales du Québec, qui nous entretiendra des divers thèmes de notre symposium.

Demain, nous examinerons la question de l'élaboration des stratégies d'échanges et d'investissements internationaux par nos divers paliers de gouvernement. Voilà le programme.

En terminant, au nom des deux Instituts responsables de l'organisation de ce symposium, je remercie les commanditaires, dont la liste figure à notre programme et qui par leur support financier ont contribué largement à la tenue de cette réunion. Enfin je vous remercie également, vous tous qui, par votre participation à ces deux jours de réflexion et de discussion, allez assurer le succès de cette réunion.

Chairman's Remarks: Constraints and Opportunities

Germain A. Denis

J'ai l'agréable tâche de présenter les deux premiers conférenciers de ce colloque. La question qui nous est posée par les organisateurs de ce colloque est de savoir quel est le lien entre le fédéralisme et la mondialisation.

Globalization is not just a noble idea; it is happening both in the world economy and in the Canadian economy.

Our traditional resource industries have always been oriented to world markets. Manufacturers around the world and in Canada are increasingly linking up to form strategic corporate alliances across national boundaries. Services are also flowing internationally, some linked to trade in goods directly and some provided in the form of transportation, communications and all the other services that cross international boundaries. International flows of technology and ideas, which affect all countries in any number of ways, are also accelerating. Globalization proceeds as well in capital markets, so much so that we all tend to take it largely for granted.

Globalization is occurring on a geographic level and is taking different forms. Western Europe's historic experience of economic and trade and indeed political integration is a case in point. We obviously have our experience with the Free Trade Agreement, and now the question of whether or not this experience of market integration should be extended to other countries.

Globalization is also happening with the breakdown of the barriers in Eastern Europe in terms of political regimes and in terms of the reorientation of their economies along market-based principles.

Similarly, globalization is happening in developing countries. The speed of the integration of the developing nations into the international economy is accelerating through the efforts to bring them fully into the multilateral trading system and through the rapid changes in the direction of their economic policy from one of import substitution to one of export orientation. For many of these countries, the resolution of the debt problem depends upon what goes on in the global trade environment and what the economic and monetary policies of major countries are.

Globalization obviously carries risks. There are the risks of the ever-present protectionist reflexes in different countries as well as the risks of seeking bilateral fixes to trade relations problems, in particular between the large trading partners: the U.S., Japan and Europe. There are also the risks of having discriminatory arrangements that would impede the process of integration and might result in the breaking down and the balkanization of the trading system. There are risks that regional integration and trading blocks could be in conflict, or engaged in collision courses. We must think seriously about how all the bilateral and multilateral arrangements are going to fit together in an open global trading system underpinning globalization. There are also risks that international institutions like the GATT will not be able to keep up with the pace of development in world markets.

Globalization also requires appropriate domestic policy responses. There are domestic sectors that are obviously going to have to continue to adjust to international competition. Some may be inclined to resist rather than to facilitate the structural adjustments that are required by globalization. This creates different perceptions in different regions because developments in global markets do not impact equally on different regions. Agriculture in this country is a good example of this phenomenon where it is necessary to ensure that Canadian positions at the international negotiating table are balanced.

Globalization is obviously testing our domestic institutional arrangements and our capacity to respond and to cope effectively with international developments. Certainly it is putting pressure on governments to develop negotiating positions in a coordinated manner, taking account of the areas of jurisdictional responsibility. A key element is the information flow between the various levels of government in Canada and the sharing of assessments of the implications of international developments. Globalization will not wait for us. Hopefully, we will not miss too many opportunities in the process. What is important to understand is that even the bigger countries have to respond to these international developments, because they no longer can dictate the sort of international trading arrangements that they would like to see.

Globalization is also creating opportunities in terms of trade and investment opportunities. It can help to enlarge our perspectives in coming to grips with our domestic agenda, whether it is trade, economic or political. It is always healthy and useful to look at the larger picture.

In sum, the challenge that is facing this conference is the challenge facing Canadian governments collectively in developing domestic economic policies in a manner that takes global economic developments into account. This is necessary if Canada is to be able to participate effectively in international trade negotiations, whether it be agricultural subsidies and import barriers, public procurement practices, rules concerning industrial subsidies and standards, including environmental issues, services, or investment issues. It is also necessary to consider these dimensions for the implementation of international agreements.

This conference offers us the opportunity of reflecting on these issues rather than leaving them to happenstance.

Europe in the 1990s: Coping with Internal and External Economic Change

André Sapir

During the first 15 years after the Treaty of Rome, the European Community (EC) enjoyed rapid trade and economic growth. After 1973, however, rising structural problems and unemployment led EC member states to slow down — or even reverse — the process of European integration.[1] Most observers pointed towards the same diagnosis of the European malaise: the existence of market rigidities responsible for the sluggish response of European economies to the shocks of the 1970s and 1980s. The policy challenge of 1992 consisted in the implementation of structural changes designed to create the conditions for renewed growth of output and employment in Europe.

The 1992 program entails removing all barriers to the free circulation of goods, services and factors of production inside the Community. The completion of the internal market seeks to improve European specialization and efficiency, intensify competition, and, thereby, foster economic welfare.

The purpose is also to answer the challenge posed by competitors at both ends of the "technological spectrum": the newly industrialized economies (NIEs), which rival EC producers in mature sectors using relatively standardized production technologies; and the United States and Japan, whose strength lies in high-tech sectors dominated by oligopolistic corporations that can take advantage of scale economies and learning by doing. The concern in Europe is especially vivid at the upper technological end because it encompasses sectors that are viewed as vital. To the extent that these sectors are subject to scale economies, the fragmentation of the European market by domestic protectionist measures has undermined the European industry.[2] Part of the challenge of 1992 is to remedy this situation.

The 1992 program, although conceived for purely internal reasons, has attracted much attention worldwide. The reason is obvious. The Community is the second largest economy in the world and largest trader. Its share in world trade is larger than that of the United States and Japan combined.

This paper examines the external dimension of 1992. It is divided into three parts. The first one assesses the external impact of 1992 both institutionally and on trade flows. The second section looks at the relationship between 1992 and the GATT, with special emphasis on the Uruguay Round. The third section offers some views on the additional gains and costs of external liberalization compared to internal liberalization and speculates on the future role of Europe in the international trading system in the light of recent events.

The External Impact of 1992

This section focuses on one aspect of the completion of the internal market, namely the elimination of barriers to trade in goods. It is divided into two parts. The first one provides an analysis of the impact of 1992 on the common commercial policy, focusing on institutional and policy aspects. The second part explores the potential effect of 1992 on trade at the sectoral level.

THE COMPLETION OF THE COMMON COMMERCIAL POLICY

Although a central part of the Treaty of Rome was the establishment of a common commercial policy towards third countries, it did not, in fact, provide a definition of commercial policy. Article 113, which confers the Community its powers over commercial policy, only states that the common commercial policy shall be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalization, export policy and measures to protect trade such as those to be taken in case of dumping or subsidies.

As a result, member states have kept a certain degree of liberty in the application of commercial policy measures against third countries. This has led to a long-standing dispute over the division of powers between the Community and the member states.

The completion of the internal market — because it will ensure the free circulation of goods and services within the Community — requires a parallel expansion of the Community's competence in the field of external trade.

In the field of goods, the main barriers still existing to intra-EC trade are: border controls, technical barriers and public procurement policies. The removal of each of these barriers has external implications.

Abolition of Border Controls

The completion of the internal market implies that after 1992 intra-EC trade will no longer be subject to border controls. This will have a direct implication in four areas of commercial policy: the import regime, the export regime, safeguard arrangements and the management of Community quotas.

As far as the import regime is concerned, the problem lies with quantitative restrictions on imports from third countries, which member states had introduced prior to the formation of or their accession to the EC and have continued to maintain ever since. National import quotas, however, could be partly ineffectual given the principle of free circulation of goods within the EC regardless of their origin. In order to prevent trade deflection (i.e., indirect imports of restricted third-country goods via another, unrestricted, member state) of particularly sensitive products subject to quantitative restrictions, Article 115 enables member states to request the Commission to suspend the free circulation of imports originating from third countries. Clearly, the effectiveness of Article 115 depends on the possibility of border controls between member states. Their elimination implies, *de facto*, the abrogation of Article 115 and the necessity for member states to adopt a common stand on quantitative restrictions.

Since 1987, the Commission has progressively tightened the conditions for granting protection under Article 115. In 1989, there were still 20 product categories covered by the application of Article 115. Among these categories, five are particularly sensitive: textiles and clothing covered by the Multi-Fibre Arrangement (MFA); automobiles; footwear; consumer electronics; and bananas.

The Community has not yet announced the shape of its future commercial policy in the areas covered by Article 115. There are two obvious alternatives to the present system of national quotas. One is the simple abolition of quotas, which is the most likely outcome for the 15 not-too-sensitive product categories (such as handtools, sawing machines, tiles, tires and umbrellas) still covered by Article 115 restrictions. The second alternative is the introduction of Community quotas, which is more likely for sensitive products such as cars, color TVs and bananas. The problem, however, is that the replacement of national quotas by an equivalent Community quota would not only raise prices in previously open markets, but might also raise the average price in the Community if foreign producers enjoy some degree of monopoly power.

Another possibility, however, is that national quotas will be replaced by Community "voluntary" export restraints (VERs), rather than by Community quotas. This possibility is particularly strong in view of the fact that many of the sensitive products are already subject to both national quotas and national or Community VERs. For instance, Japanese car exports to the EC are restrained by quotas in Italy, Portugal and Spain and by VERs in several other member states. In January 1988, the Commission demanded that Japan accept a temporary Community VER in exchange for phasing out national import restraints. The objective of European car manufacturers is, reportedly, to freeze Japanese exports at the 1985-86 level of one million cars. In principle, the VER would be lifted after 1992. But based on past experience, there is little hope for such an outcome. The first ever Community VER was introduced in February 1983 to limit Japanese exports of video recorders.[3] It formally lapsed in January 1986 but was renewed soon afterwards along with a VER agreement with Korea. Both VERs are still in place, along with a quota in Spain and a VER in France.

Concerning the export regime, the main problem arises from national export controls on certain products in the framework of the Coordinating Committee on Multilateral Export Controls (COCOM). At the present, member states carry such controls pursuant to national laws, regulations and administrative practices. The Commission is attempting to harmonize the relevant measures.

A number of member states still maintain bilateral safeguard arrangements with third countries, in particular with Japan. So far, proposals by the Commission to complete the harmonization of safeguard rules have failed.

Finally, the elimination of border controls requires the modification of the present management of Community quotas. The problem arises, especially, with respect to preferential arrangements — such as the Generalized System of Preferences (GSP) — which include tariff quotas allocated among the member states. The need to modify the present system was recently underscored in a ruling by the European Court of Justice that declared illegal the national allocation of GSP tariff quotas. The Commission is preparing a new set of measures for managing Community quotas.

Elimination of Technical Barriers

According to the Commission of the European Communities (1988), technical barriers (i.e., technical standards or regulations and certification procedures) constitute the most important obstacle to intra-Community trade. They also cover a wide spectrum of industries ranging from motor vehicles, electrical and electronic equipment to footwear, paper products and man-made fibers.

Earlier attempts to eliminate technical barriers had focused on international harmonization. In view of the difficulty in bringing together long-standing national rules, the 1992 project is based instead on the principle of mutual recognition. This principle derives from the 1978 decision of the European Court of Justice in the *Cassis de Dijon* case, whereby a German requirement resulting in the exclusion from the German market of certain liqueurs from other EC members was found contrary to the Treaty of Rome. Mutual recognition implies that products lawfully marketed in one member state must be admitted to the market of all other member states. The principle does not, however, apply to health and safety regulations, for which Community standards are being established.

The principle of mutual recognition has a direct impact on extra-Community imports. By virtue of the principle of free circulation referred to earlier, mutual recognition means that third-country products that are imported by and marketed in any member state must be granted access to all other member states, regardless of whether they fulfill the regulations of these states. For instance, after 1992, American products that meet Spanish standards and are imported into Spain will have to be admitted to the German market, even though they may not conform to German standards. Hence, suppliers from third countries will, in principle, benefit from the elimination of technical barriers within the Community.

Nonetheless, technical regulations will continue to impose a barrier against foreign producers in several ways. First, the Community might adopt strict harmonized health and safety standards that could prove difficult to meet for developing countries. In 1986, the Commission had to drop a Community standard on chocolate at the request of some member states fearing for the interests of developing country producers. Stringent health standards might also affect industrialized country producers. One such instance is the 1988 Community standard on hormone-treated meat for which the United States has obtained a one-year exemption. If applied in 1989, the EC's ban on hormones would bar about $150 million of U.S. beef from the Community and could result in retaliatory actions. Second, the Community could introduce technical standards for high-tech products (such as computers and telecommunications equipment) designed to exclude, at least temporarily, foreign suppliers. Third, the principle of mutual recognition that applies to indirect imports may not extend to direct imports. In the previous example, this would mean that direct imports from the United States into the German market would still be prohibited; only indirect imports via the Spanish market, adding to the costs of transportation of American exports, would be allowed.

On balance, the elimination of technical barriers within the Community is probably good news for foreign suppliers. A similar view is expressed in a recent U.S. report on a European single market:

> Under EC 1992, a U.S. exporter will have to meet only one standard and have its product tested in one EC member state to sell throughout the EC. Therefore, U.S.

exporters will probably not be any worse off than they are under the current system and could be much better off.[4]

Opening up Public Procurement

The importance of purchases by public bodies reportedly varies between 10 and 20 percent of GDP in the 12 member states. The overwhelming majority of public procurement is biased in favour of domestic suppliers.[5] As a result, the import content of public supplies is several times lower than the import content of private supplies for similar product categories.[6] The completion of the internal market is expected to remove discriminatory public purchasing practices within the Community.

The 1992 project will have an important external impact since importers and subsidiaries from third countries established in the Community will enjoy the same access to public markets as EC producers. However, in sectors not covered by multilateral agreements, the Community will not grant equal treatment to foreign producers. The EC decision of February 1990 indicates that entities procuring in those sectors are permitted to exclude from consideration offers with less that 50 percent EC content. In addition, if they do consider such bids, preference must be granted to an EC offer if it does not exceed non-EC bids by more than a 3 percent margin.

THE IMPACT OF 1992 ON EC TRADE

The external impact of the internal market depends on three factors: the removal of nontariff barriers, the relative competitiveness of European producers and the EC's trade policy. The elimination of NTBs inside the Community should lead to an increase in imports as domestic producers lose some of their protection. The winners of the trade expansion could be Community producers or producers from third countries, depending upon their relative strength and the shape of Community commercial policy.

Although these three factors will have an effect on most activities, their precise impact is likely to vary a great deal across sectors. The assessment of the external impact of 1992, therefore, requires a two-step procedure. The first one consists of the identification of the sectors that are currently most affected by nontariff barriers. The second step involves, for these sectors, the detailed analysis of both the relative competitiveness of EC producers and the common commercial policy.

The first step has already been conducted by Buigues and Ilzkovitz who have classified over one hundred three-digit manufacturing sectors according to the extent of market fragmentation in the Community.[7] Their study uses two indicators of fragmentation: nontariff barriers and price dispersion. The authors identify 40 sectors as being particularly sensitive to the completion of the internal market, 14 with high and 26 with moderate nontariff barriers.

In order to assess the external impact of the internal market, I have ranked 38 of the 40 sectors — two sectors could not be classified due to lack of data — according to the importance of domestic producers in their local market.[8] Three groups of sectors can be distinguished.

Group one is comprised of 11 sectors where domestic producers are, so far, practically unrivaled, accounting for at least 80 percent of sales on their local market. All the sectors included in this group are characterized by a high level of NTBs in the form of either technical barriers (food-processing activities, pharmaceuticals) or government procurement (boilermaking, railway equipment, shipbuilding, insulated wires and cables, electrical machinery).

Group two includes 14 sectors where domestic producers, although they remain the principal suppliers of local markets (with a share of between 45 and 70 percent), are under strong competition from Community or third-country firms. With the exception of telecommunications where public procurement is all-important, this group contains sectors displaying a moderate level of nontariff barriers caused by technical standards. These barriers have not, generally, prevented a fair amount of intra- and extra-EC imports.

Group three contains 13 sectors where domestic suppliers account for no more than 40 percent of local sales and, with the exception of two sectors, the main source of supply is foreign. Like the previous group, this one is comprised of sectors with generally moderate nontariff barriers resulting from technical standards. Three exceptions are medical equipment, aerospace and office machinery (including computers), which are relatively dependent on public procurement. Despite (or because of) these barriers, foreign producers already dominate the market in the member states.

The external impact of 1992 will vary substantially across sectors, with two clearly distinct categories of activities.

In the first category the completion of the internal market will have relatively little external impact because EC suppliers have either a very strong competitive position (most sectors in group one) or a very weak one (most sectors in group three). Yet, some of these industries could be affected by changes in trade policy not directly related to the completion of the internal market.

The second category comprises sectors, many with a declining competitive position of EC producers, where most of the impact of 1992 on foreign producers can be expected. The nature of this impact will depend upon the type of sector and the underlying determinants of trade.

In traditional sectors, characterized by low or medium R&D-intensity and scale economies (many sectors in group two, but also others such as shipbuilding, footwear, or textiles), European producers have already lost much ground to foreign producers, especially developing country ones, despite important barriers to trade. This dynamic of comparative advantage should be amplified after 1992, provided the common commercial policy is not used instead of much needed (and more effective) structural adjustment measures.

On the other hand, in high-tech sectors featuring relatively important scale economies (such as telecommunications, aerospace or, to a lesser extent, computers), the removal of barriers fragmenting the EC market could help revitalize European producers. There is also a possibility that policy-makers, under pressure from powerful interest groups, apply neo-infant industry protection to these high-tech oligopolistic industries, while other policies — such as research programs and increased competition — seem more relevant for social welfare.

I will further pursue the distinction between traditional and high-tech sectors in the last section of the paper.

1992, GATT and the Uruguay Round

The external implications of the completion of the internal market fall into two categories. In some instances, internal liberalization will give rise automatically to external liberalization. In other cases, however, the possibility for third countries to improve their access to the EC market after 1992 will depend on Community commercial policy measures still pending. In the latter situation, the Community is seeking reciprocal concessions from its partners in exchange for improved market access in the wake of 1992.

The room for manoeuvre in the quest for reciprocity with respect to a particular commercial policy instrument depends on whether this instrument is already covered by GATT or not. If it is, the scope for reciprocity is rather limited. The situation is entirely different, however, for trade measures not covered by GATT. In this case, the Community is free to seek full reciprocal benefits from its partners via either bilateral or multilateral negotiations. Such freedom is fully pursued by the Community in the ongoing Uruguay Round.

The remainder of the section is divided in two parts. The first examines existing GATT rules that bear upon internal EC liberalization, while the second part looks at the interaction between 1992 and the Uruguay Round. The first part focuses entirely — like section one — on manufactured products; the scope is enlarged in the second part to agriculture and services.

1992 AND EXISTING GATT RULES

In the case of trade policy measures already covered by the General Agreement, further distinction must be drawn between situations where the Community is bound by the principle of non-discrimination and instances where Article XXIV (relating to customs unions and free-trade areas) can be applied. If the most-favoured-nation (MFN) principle prevails, the Community must extend the benefits of 1992 to all GATT members without any reciprocal concessions. In matters covered by GATT, the Community can only seek reciprocity if it is able to maintain an element of discrimination between members and non-members (like the common external tariff) by virtue of Article XXIV.

The analysis in the previous section has identified some of the commercial policy instruments that will require action by the EC in connection with 1992 in the area of manufactured products: quantitative restrictions, safeguards, technical barriers, and government procurement. I will briefly review the treatment of these instruments in GATT.

The Agreement calls for the general elimination of quantitative restrictions to trade subject to a number of qualifications, including an escape clause (Article XIX) intended to safeguard domestic industries seriously injured by imports. Article XIX insists on equal treatment of all imports of specific products and compensation of supplying countries. In reality the article has been largely ignored as countries apply selective discriminatory quotas and VERs in violation of GATT rules. The Tokyo Round attempted to bring safeguard actions back within the boundaries of GATT, but stumbled on the issue of selectivity. The safeguard issue is back on the agenda of the Uruguay Round, with selectivity again the dominant concern for negotiators. Proponents of selectivity, primarily the EC, argue that safeguard actions should apply only to countries causing the injury, therefore reducing the use of protection. On the other hand, many of the smaller (especially developing) countries in GATT stress that selectivity in fact increases protection by lowering the costs of safeguard actions to the importing country. These countries are particularly keen on the non-discriminatory application of Article XIX in order to prevent large countries from abusing their bargaining power in bilateral negotiations.[9] Unless an agreement limiting selectivity can be reached in the Uruguay Round, small countries can fear that the abolition of border controls and the abrogation of Article 115 will be detrimental to their interests. The transformation of national quotas into Community quotas (or VERs) after 1992 would, then, reduce their retaliatory power against selective measures taken by a block of 12 countries instead of individual member states.

The Tokyo Round was the first comprehensive attempt to bring nontariff barriers within the discipline of GATT. It produced a series of agreements on codes of conduct for NTBs, two of which have direct relevance for the completion of the internal market: the agreement on technical barriers to trade and the agreement on government procurement. Both codes provide rules on national and non-discriminatory treatment of imported products originating from signatory trading partners. There is some legal confusion about the possibility for the Community to invoke the rules on free trade areas in Article XXIV with respect to these two codes.[10] Accordingly, it is not clear whether the Community is able to apply different technical regulations or public purchasing practices to member states and third countries, and therefore to seek reciprocity in GATT negotiations on matters covered by the codes. The coverage of the GATT codes, however, is much more restrictive than the 1992 project. For instance, the standards code does not deal adequately with testing and certification procedures; and the government procurement code does not apply to the key sectors of transport, energy, water supply and telecommunications, nor to all public authorities. This means that the Community enjoys large discretionary power in negotiating access to the EC market either bilaterally or multilaterally.

1992 AND THE URUGUAY ROUND

As many observers have remarked, the Uruguay Round is the most complex international trade negotiation ever. It aims not only at strengthening existing GATT rules, but also at broadening their coverage, particularly to agriculture and services.

The Uruguay Round poses a special problem to European nations seeking to complete the Internal Market by 1992. There is a possible conflict of interest between internal liberalization within Europe and the global liberalization being sought in the GATT round. Some have even argued in Europe that the construction of a single market ought to be accompanied by an increase in protective barriers around the Community so as to prevent foreign companies from reaping most of the benefits. According to the White Paper on Completing the Internal Market, the areas most concerned by the possible clash between internal and external liberalizations are manufacturing and services. But there may also be some problems in agriculture.

In manufacturing, all the issues of the internal market where existing GATT rules are inadequate or incomplete are on the agenda of the Uruguay Round. The main issues and the overlap between 1992 and the Uruguay Round negotiations are:

Textiles. The principal aim of the negotiation in this area is the integration of textiles into the GATT. There is likely to be, however, a transition period during which quantitative restrictions will remain in place. In any event, as far as the Community is concerned, the allocation of MFA quotas among the member states (and their enforcement with the help of Article 115) will have to disappear by 1992. Member states might, nonetheless, retain a certain degree of autonomy over MFA quotas given that they are, in fact, VERs managed by exporting countries.

MTN codes and arrangements. The objective in this negotiating group is to improve or expand codes and arrangements negotiated in the Tokyo Round. The three main areas of overlap with 1992 are: the standards code, the anti-dumping code, and the government procurement code. The position of the Community in standards and government procurement is quite strong since the scope of the 1992 program is much wider than that of current GATT codes. It seeks to expand the coverage of the codes in these two areas. In particular, the Community has offered to broaden the code on government procurement to the four GATT-excluded sectors covered by 1992 (transport, water, energy and telecommunications). It is also looking for an extension of the procurement code disciplines to sub-national authorities and special private entities. The EC declaration of February 1990 on government procurement states that the decision of not granting equal treatment to foreign producers will be reconsidered in the light of progress achieved in the Uruguay. In contrast, the position of the Community is much weaker in the negotiation on the anti-dumping code where it is seeking to tighten existing GATT provisions. The EC has been under attack, recently, for allegedly using anti-dumping actions in conjunction with its 1992 program, especially in sensitive sectors.[11] The Community's standing has been further damaged by a recent GATT panel ruling on the use of rule of origin in the EC screwdriver assembly provision.

Safeguards. The Community plays a major role in the negotiating group on safeguards. It is the only delegation that strongly advocates selectivity, although the United States and Japan are not opposed to the departure from the MFN principle. The interest of the EC in seeking to tighten Article XIX of the GATT is especially pressing in view of the *de facto* abrogation of Article 115 by 1992.

In agriculture and services, two areas also affected by the internal market, the Uruguay Round seeks to impose multilateral discipline where GATT rules have been nonexistent in the past.

Although agriculture, as such, does not occupy an important place in the 1992 program, it is bound to be affected by the removal of border controls. So far, the EC market for agricultural products has been segmented by monetary compensatory amounts (MCAs), a crucial feature of the Common Agricultural Policy (CAP) enabling member states to tax or subsidize intra-EC trade. Without border controls, MCAs will have to be abolished and prices of agricultural products will become uniform throughout the EC.[12] The effect on third countries will depend on whether the abolishing of MCAs raises or lowers average prices in the Community. This, in turn, will depend crucially on the outcome of the Uruguay Round.

Services are a crucial part of the 1992 program. This is one area where, in the absence of multilateral rules, the EC has voiced demands for reciprocity. Such demands follow from the fact that freedom to provide services within the Community after 1992 will imply that firms from any member state will be granted rights of establishment and national treatment throughout the Community. Since Article 58 of the Treaty of Rome considers foreign-owned subsidiaries as nationals of member states, it means that they will have full access to the unified internal market even though their home country might not grant such treatment to EC firms. The issue of reciprocity has been raised particularly in the context of financial services where, after much agonizing, the Community finally settled for a relatively mild form of reciprocity. Thus, the EC's banking directive of April 1989 indicates that the Commission may seek reciprocal treatment from countries where "credit institutions from the Community do not enjoy national treatment and the same competitive opportunities as domestic credit institutions." Clearly, as in the case of government procurement, the Community's motivation is clear: "[i]t wants to have negotiating chips in the Uruguay Round".[13]

Coping with Internal and External Liberalization

With less than three years to go, the deadline of December 1992 for completing the internal market seems within reach. The pace of integration has speeded up considerably and the "Euro-optimism" of the nineties has displaced the "Europessimism" of the eighties. The Commission's attempt to deregulate markets and reinvigorate Europe is well under way.

As the process of internal liberalization unfolds, the Community is ever more confronted with important external choices. The December 1990 deadline for the Uruguay Round makes this issue a particularly acute one.

In this section, I examine the desirability and the feasibility of a strategy for Europe combining the completion of the internal market with a further opening to the rest of the world.

There is wide consensus that increased competition in the European internal market is the key for potential benefits from the 1992 program. The removal of intra-EC barriers affects the degree competition via both trade and investment activities. Increased intra-EC trade is likely to raise the level of competition. As far as investment is concerned, the effect on competition is, however, ambiguous as increased merger activities may lead to less competition. Community policies are, therefore, required in order to ensure that, on balance, the single market program results in increased competition.

Elements of a Community-wide competition policy have already been put into place. But lowering trade barriers against extra-EC imports could also be a powerful instrument for promoting competition in the European Community. Theoretical and empirical research indeed suggest that import competition imposes a major constraint on domestic firms' price-cost margins.

In a recent paper, Jacquemin and Sapir examined the relative trade discipline of intra-EC and extra-EC imports on European industry performance.[14] Their study involves an econometric estimation of a structure-performance equation that distinguishes between actual and potential, as well as intra-EC and extra-EC, imports.

The major result of the paper concerns the respective roles of actual intra-EC and extra-EC imports. The econometric estimates reveal that only extra-EC imports currently exert a significant disciplinary effect on price-cost margins. Intra-EC imports were found to exert no disciplinary impact at all. This might suggest that European producers currently engage in various restrictive business practices.

The Jacquemin-Sapir paper also finds that intra-EC NTBs add significantly to price-cost margins. This confirms the potential pro-competitiveness of the 1992 program. The effect, however, is limited to sectors subject to the highest level of NTBs.[15] These sectors include activities with important public procurement and advanced technology (such as computers and telecommunications equipment).

An open policy towards third countries in high-tech sectors is, therefore, desirable to the extent that it would reduce the threat of monopoly power on the EC market. At the same time, however, government authorities are subject to intense pressures on the part of various lobby groups bound to gain from protectionist policies. The possibility of success of such pressure is especially great under the present international climate of drift towards economic blocs. External liberalization is also desirable in traditional sectors where the Community must reverse certain policies and foster — rather than oppose — the dynamics of comparative advantage. Such steps are particularly important in labour-intensive activities (such as textile and clothing) where the competitive pressure from developing countries is ever increasing. The need to transform the pattern of production is particularly urgent in southern Europe whose cost advantage vis-à-vis northern Europe — with a wage ratio of one to five between Portugal and Germany in the clothing sector — is threatened by an equal cost disadvantage vis-à-vis certain developing countries (with a wage ratio of one to five between India and Portugal in clothing). The adjustment in southern Europe is all the more urgent since it has already occurred in the NIEs. Thus, between 1965 and 1985, the share of textile and clothing in manufactured exports has fallen from 68 to 44 percent in S. Korea, from 49 to 35 percent in Hong Kong and from 17 to 7 percent in Singapore. Meanwhile, this share went from 21 to 46 percent in Greece and from 39 to 37 percent in Portugal — but from 15 to 6 percent in Spain, where the adjustment has been spectacular.[16]

What is the likelihood, then, that the Community eases the access to its internal market? Does 1992 increase or decrease the chance of external liberalization in the context of the Uruguay Round?

On the one hand, it appears that 1992, by having created the present climate of "Euro-optimism," plays a very positive role in helping to promote the international division of labour. The increase of economic growth and the reduction of unemployment in Europe have, generally, lowered the demand for protection.

On the other hand, it could be argued that external liberalization would add an unbearable weight to the burden of structural adjustment that might result from internal liberalization. In the earlier phase of European integration, such a burden was relatively minor. The main reason was the increase of intra-industry specialization rather than inter-industry specialization. This phenomenon occurred not only within the Community but also with third countries as trade expansion focused primarily on industrialized nations with similar production patterns. Agriculture, the one area where trade liberalization among industrialized countries could have led to substantial inter-industry specialization, was excluded from the process of tariff reduction precisely to avoid painful political problems. The 1992 program, however, could impose much greater economic adjustment, not least because of the disparities in economic configurations among the present 12 member states. But even among countries with relatively similar economic conditions, the removal of existing nontariff barriers is likely to cause important changes. For instance, the opening up of national public procurement should leave only a few of the present European producers after 1992 in certain industries subject to important economies of scale. These factors would increase the demand for protection in Europe.

Although it is difficult to judge whether the balance is likely to tilt towards more or less demand for protection in the Community, my own feeling is one of cautious optimism. There are, however, three additional factors that need to be taken into account in assessing the likely position of the Community in the final phase of the Uruguay Round.

The first factor concerns the thorny issue of decision-making in the Community. By virtue of Article 113 (Treaty of Rome), the EC Commission conducts trade negotiations with third countries. It must, however, proceed in consultation with the Council (i.e., the member states) which defines the negotiating framework. In practice, this means that the Commission spends as much energy negotiating with — or second-guessing — member states as with third countries. Final decisions are taken by the Council, acting as a qualified majority. With the present membership of 12 countries, and given the number of votes allotted to each country, both protectionists and liberals have a blocking minority in the Council. Accordingly, "in the debate about how open or closed the external trade stance of the EC is likely to be, ...outcomes [depend] on the attitudes of the median group, individual issue by individual issue."[17] In view of the complexity of the Uruguay Round and the varied interests of the 12 member states, much doubt will remain on the overall stand of the Community until the final negotiation in December 1990.

The second factor is that the United States is increasingly suffering from a "rogue elephant" syndrome due to its loss of hegemonic power. The U.S. frustration with the multilateral system has turned into a growing mood of bilateralism, especially towards Japan. Given their own frustration with Japan, some analysts in Europe suggest that the EC should join the United States in bashing Japan, perhaps by forming an Atlantic Union. Others recommend keeping a low profile while the United States does the job, hoping nonetheless to collect some benefit from the eventual opening of Japan. Neither of these alternatives, however, is very convincing. The United States has no interest in siding formally with Europe; it is much better off to remain free and ally itself with Europe or Japan depending on the issue. Equally, it would be naive to believe that U.S. bilateral actions would help the EC in obtaining freer access to Japan. The Community would be better advised to adopt a leadership position aimed at reinforcing the multilateral system.

Finally, the opening to and of the eastern European economies may play an important role in shaping Brussels' view on multilateral liberalization. Some voices argue that the EC must choose whether to open regionally to east Europe or multilaterally to developing countries. These voices often add that their preference goes to eastern Europe because it offers better market prospects than most developing countries. Others adopt a more global approach and caution against the risk of "Euro-centrist" attitudes that would be detrimental to the EC's long-term interest. Everyone agrees, however, that events in eastern Europe may alter the international division of labour and affect the 1992 program.

NOTES

1. A. Jacquemin and A. Sapir, "European integration or world integration?" *Weltwirtschaftliches Archiv*, 124, 1988, pp. 127-39.
2. For econometric evidence of the impact of trade barriers and scale economies on European competitiveness, see A. Jacquemin and A. Sapir, "International trade and integration of the European Community: An econometric analysis," *European Economic Review*, 32, 1988.
3. For discussion, see B. Hindley, "European Community imports of VCRs from Japan," *Journal of World Trade Law*, 20, 1986, pp. 168-84.
4. United States General Accounting Office, *European Single Market: Issues of Concern to U.S. Exporters* (Washington: D.C.: National Security and International Affairs Division), p. 27.
5. See the Commission of the European Communities, "The economics of 1992," *European Economy*, 35, 1988, pp. 1-235.

6. See J. Pelkmans and L.A. Winters, *Europe's Domestic Market*, Chatham House paper no. 43 (London: Routledge, for the Royal Institute of International Affairs, 1988).
7. P. Buigues and F. Ilzkovitz, "Les enjeux sectoriels du marché intérieur," *Revue d'Economie Industrielle*, 1988.
8. For a more detailed account, see A. Sapir, "Does 1992 come before or after 1990?" in R. Jones and A. Krueger (eds.), *The Political Economy of International Trade* (Oxford: Basil Blackwell, 1989).
9. See G. Sampson, "Safeguards," in J.M. Finger and A. Olechowski, *The Uruguay Round: A Handbook on the Multilateral Trade Negotiations* (Washington, D.C.: The World Bank, 1987).
10. See J. Steenbergen, "Trade regulations after the Tokyo Round," in E.L.M. Völkner (ed.), *Protectionism and the European Community* (Deventer: Kluwer).
11. See P. Messerlin, "The EC antidumping regulations: A first economic appraisal, 1980-85," *Weltwirtschaftliches Archiv*, 125, 1989.
12. Pelkmans and Winters, *Europe's Domestic Market*
13. M. Wolfe, "The battle between liberalism and mercantilism: The external impact of the single market programme," paper prepared for a meeting of the Hague Group on Europe and the South, Thoresta, Stockholm, 13-15 October 1989, p. 24.
14. A. Jacquemin and A. Sapir, "The discipline of imports in the European Market," paper presented at the Conference on the Impact of 1992 on European Trade and Industry, organized by CEPR, STEP and Confindustria, Urbino, 15-16 March 1990.
15. This is defined in the study by Buigues and Ilzkovitz, "Les enjeux sectoriels."
16. A. Jacquemin and A. Sapir, "Ouverture interne et externe du grand marché européen: Gains d'efficacité, coûts d'ajustements et nouveaux instruments communautaires," mimeo, 1990.
17. H. Wallace, "Dealing in multiple currencies: Negotiations in the European Community," (London: Routledge, for the Royal Institute of International Affairs, 1989) mimeo.

Canada in the 1990s: Coping with Internal and External Economic Change

Thomas J. Courchene

Introduction

My assigned role was to comment on André Sapir's contribution and in particular to focus on the resulting implications for the Canadian federation. Since the thrust of his paper is beyond my area of expertise, some role re-assignment is imperative. Hence, what I shall do is parallel (for Canada) his title and then deal with four general themes:

- **the winners and losers in the globalization game;**
- **"Canada 1992": a single national market in financial services;**
- **the exchange-rate implications of the FTA; and**
- **financial integration and macro policy.**

In elaborating on these themes, particularly numbers one and three, I shall relate the analysis to that in Sapir's paper.

Some Impacts of Globalization

Based largely on insights drawn from others, I have come to view globalization as benefiting at least three agents/institutions. The first winner is the multinational corporation. Indeed, if the concept of "national treatment" comes to dominate free trade agreements (as it dominates the FTA) we should see the multinational transformed into a "transnational." For present purposes, the multinational is defined as a global corporation that accesses various national markets provided that it conforms to the range of operating procedures imposed by host countries. Under "national treatment" these corporations would have the same domestic rights as home-country corporations. This means that they can become transnational (or supra-national) corporations. Not only can they then roam the globe operating out of, say, Chicago but this transnational status in combination with globalization substantially enhances the value of their patents, copyrights, brand names, etc.[1] I will not dwell further on these global corporations, although some implications do arise in terms of Europe 1992, and the creation of a unified European market.

The second group of winners are "individuals." In part, this is due to the fact that individuals now have access to a vastly enhanced pool of information as well as the technology to handle this information. This is the power-to-the-people syndrome and it greatly complicates governance, particularly for those governments that wish to wield considerable control. Some may prefer to view this as a transfer of power to markets that, in turn, are inherently decentralizing.

A more general definition is that globalization enhances *mobility* across a broad range of fronts and the greater the mobility the more difficult it is to exercise control. Consider telecommunications. The availability of "by-pass" essentially eroded Teleglobe's monopoly and led eventually to its privatization. Here, global information flows and information technology have redefined the private-sector/public-sector boundaries. Likewise, the possibility of "by-pass" will eventually bring down long-distance rates and put an end to the subsidization of local telephone service by long-distance charges. The implications of all of this will be spelled out shortly.

The third winners are the major cities. Borrowing from ongoing work by Mario Polèse and Daniel Latouche at INRS (University of Quebec), one can note that, as a result of globalization, nothing much has changed over the last decade in terms of the relationship between Ottawa and Bonn. What has changed, however, is the relationship between, say, Toronto and Frankfort. This represents a major challenge to Canadian federalism since cities play no role, constitutionally. Yet the budget of metropolitan Toronto must be larger than the budgets of most of the provinces. Moreover, what happens in Toronto is increasingly important for defining our industrial, economic and even cultural future and identity. It may well be that, over time, the telecommunications and information revolution will spill out to the regions and peripheries. However, for the relevant planning horizon, the information revolution is a world-class-cities phenomenon. Montreal (Toronto) will become more and more like Paris (London) and less and less like Trois Rivières (Kingston).

The real losers in this globalization game are national governments. Free trade agreements, defence treaties, environmental pacts, increasing international regulatory rules for areas such as financial institutions and accounting firms, and on and on, have transferred traditional nation state *external* powers *upward* (to the FTA, for example). I have already argued that globalization transfers some traditional *domestic* powers *downward*, either to markets or to individuals.

Two implications flow from this. The first is that, increasingly, sovereignty will come to mean the ability of a community to influence how its citizens live and work and play. This is what the "distinct society" of Meech Lake fame is all about. And this is why, for Quebecers, sovereignty association is probably preferable to outright independence since that latter would immediately require a whole series of international pacts and alliances so that all that is effectively left is how Quebecers will live and work and play. As an important aside, in a generation or two British Columbia will be largely Pacific-Rim oriented and perhaps Pacific-Rim populated so that it, too, will insist on distinct-society status. If we cannot accommodate Quebec, then we will also be unable to accommodate British Columbia.

Complicating all of this is that Ottawa is broke. The natural forces of decentralization are being reinforced by paring back on provincial transfers, which either: (a) increase decentralization in that the provinces will now occupy a larger share of overall taxation, or (b) increase decentralization in the sense that the provinces will re-design the so-called national programs.

Yet it appears that a substantial and influential element of English Canada is seriously misreading globalization and is yearning for some version of a more centralized federation. What is true is that globalization is challenging us to redefine a unifying and integrating role for the federal government. Just what this new role ought to be is not as yet clear. But it is not the traditional role and the failure to realize this is an important aspect of the Meech Lake impasse.

Canada 1992

Europeans are teaching Canadians a lesson. They are designing a system for creating a single market in financial services across national boundaries whereas we cannot move financial services free and freely across provincial boundaries.[2] Briefly, three principles underlie European financial market integration. The first is "mutual recognition" by member states of the authorization for a financial institution chartered in one member state to do business in another member state. The second, and closely related, principle is that mutual recognition is subject to the harmonization of minimum standards, including minimum capital standards. Underlying this harmonization is, of course, substantial coordination, information sharing and the like among national regulators. These two principles pave the way for "home country rule" in which the regulator in the chartering nation is responsible for the supervisory oversight of the institution in its operations throughout the Community. The final principle is that the conduct-of-business rules or operating rules would be those of the host country, that is the country where the services are provided. In effect, then, the thrust of the Europe 1992 approach is that financial institutions will have a right to trade in financial services on the basis of a single "passport" from their home jurisdiction, subject only to host-country operating codes.

How do we replicate this in the Canadian federation? The Buckwold (Senate) Report presents one approach;[3] essentially a variant of Europe 1992. Basically, the chartering jurisdiction (a province or the federal government) will have responsibility for regulating the prudential aspects of financial institutions (capital, self-dealing) as well as the investment and business powers. In the Canadian context, this is generally referred to as the "designated jurisdiction" concept — other jurisdictions will designate the chartering province to perform these functions. In so doing, the designated jurisdiction will be subject to regulation of the CDIC (Canada Deposit Insurance Corporation) which, as a *quid pro quo* for providing deposit insurance, will ensure compliance with a set of national prudential standards. The designated jurisdiction concept is the rough equivalent of the European "mutual recognition" principle.

Host countries would be free to impose conduct-of-business and consumer protection rules. In effect this is a "provincial treatment" principle: these operating rules must apply equally to home-chartered and away-chartered institutions. This is not quite the "single banking licence" of the Community, since it contemplates registration and licensing in the host provinces, but it would be a major step towards financial integration. For more details, see the Buckwold Report.

This specific proposal may not hold the key to achieving a national market in financial services, but some such approach is essential since the Canadian market is reeling under extra-territorial provincial legislation (e.g., Ontario's so-called "equals approach"). The internationalization of financial services demands that Canada put its domestic house in order and Europe 1992 is demonstrating for Canada both the need for financial integration and a viable model.

The Exchange Rate and the FTA[4]

The final two points take leave of microeconomic and commercial/trade policy issues and focus (uncharacteristically, for this conference) on macroeconomic concerns. A few background observations are in order.

First, some considerable importance attaches to Peter Drucker's concept of the "symbol economy," by which he means the constellation of credit flows, exchange rates and capital markets. Drucker argues that the symbol economy is the new flywheel of the world economy.[5] Phrased differently, the symbol economy is no longer being driven by the real (goods) side of the economy: rather it is driving the real side. Exchange rates, at least over the short run, appear to have more to do with interest rates, government deficits and aggregate savings imbalances than with the "traditional determinants" such as current account deficits and purchasing power parity.

The second, and related, background point is that Canada probably has the worlds largest net external debt in absolute terms — between 200 and 300 billion dollars.[6] Certainly, it is the largest in the G7 as a percent of GNP.

Third, and again relatedly, our "twin deficits" — fiscal and current account — are now both running at roughly 1½ the U.S. rates (in terms of GNP). These last two points suggest that Canada is increasingly vulnerable in terms of the first point, namely of having our exchange rate driven by the operations of the "symbol" economy.

With these observations as backdrop, I now proceed to the third of my four points, namely that the FTA real-side integration implies that the exchange rate is going to be harder to move, politically and economically. I recognize that all of my pro-free-trade colleagues argued that a flexible exchange rate was an essential ingredient of the FTA. If employment or economic activity fell in Canada then the exchange rate would depreciate to compensate for the fall in activity. The first problem with this is, as noted, that the symbol economy rather than levels of economic activity are currently driving the exchange rate.

The second problem is that I think the basic principle is, in general, wrong. What remains true is that if the U.S. is inflating, the first best solution was, and is, to allow our exchange rate to appreciate in order that we avoid the U.S. inflation. What is wrong (or at least needs to be re-thought), however, is the use of the exchange rate to respond to terms-of-trade shifts. To see this, the starting point is the observation that as our very regionally diverse east-west economy integrates north-south with the U.S., it will become increasingly evident that the optimum currency areas are the cross-border, north-south regions, not the national economy. Using the exchange rate to counter terms of trade shifts assumes exactly the opposite, since this alters these cross-border rates while maintaining parity east-west.

(As an important aside, this integration poses a quite separate problem, namely the undermining of our east-west transfer mechanisms. As Richard Simeon has argued [and presumably will re-state in his summing-up comments later in this volume], much of the political and economic rationale for regional transfers was rooted in old-fashioned Keynesianism — transfers to the regions would not only help them out but the second-round spending would find its way back to Ontario, the principal payee. With north-south integration, the second-round spending impacts may now end up south of the border, which will undermine the political economy of these transfers.)

Returning to the issue at hand, suppose that from a position of north-south equilibrium for the west of the continent, the prices of raw materials increase. The impact of this terms-of-trade shift will influence economic prospects of western agents identically on *both* sides of the border. Because raw materials play a much larger role in overall Canadian output and exports than is the case for the U.S., suppose that our authorities (in traditional fashion) allow Canada's dollar to rise relative to the U.S. dollar. Not only does this generate a favourable price wedge for U.S. producers in the west in terms of supplying the Canadian market (and remember that under north-south integration everything from the proverbial guns to butter can and presumably will flow in both directions), but this wedge will also occur in the rest of the economy as well — Quebec now finds itself at a price disadvantage vis-à-vis the U.S. northeast where *neither* cross-border region has been directly affected by the terms-of-trade shift. In other words, *all* Canadian regions are forced to adjust while their similarly-situated, cross-border trading partners are unaffected. Or conversely, after adjusting to the U.S. northwest in terms of wages and prices, the Canadian west can be thrown out of north-south equilibrium by an appreciation of the dollar driven by an overheating of the Ontario market from an automobile boom. The proposition advanced here is that these exchange rate shifts will become more difficult to implement in an integrated North America. Phrased differently, our traditional approach to exchange rate policy is more easily accommodated when the border is closed and everything flows east and west, basically from Ontario. Not so under FTA-driven real-side integration. Space does not permit a fuller elaboration of this Canada-U.S. exchange rate issue. For more detail see Courchene[7] and Mundell.[8]

To the extent that the above assertion is correct — namely that the FTA argues for greater fixity rather than greater flexibility of the exchange rate in response to shifts in the terms-of-trade — the obvious question then becomes one of how we accommodate these terms-of-trade movements. Part of the answer is that Canada will have to tolerate greater wage diversity across provinces and regions. Earlier I argued that Toronto has joined the class of the world's great cities: it is absurd that federal employers in Toronto be on the same wage scale as those in Kingston let alone rural Ontario or rural Saskatchewan.

Another part of the answer is to resurrect provincial stabilization policy. Ontario had several excellent opportunities to take some of the steam out of its post-1983 boom. Instead, the province *spent* this fiscal dividend and increased overall Canadian absorption. Can there be any doubt that some of the 500 basis point premium on Canadian interest rates relates to the fact that Ontario did not temper its boom? Rather, it was left for the Bank of Canada to handle the overheating, one result of which was that it put the prairie farmers in the front lines of the battle in fighting Ontario-initiated inflation. The sad fact is that at no time did either Finance Minister Wilson or Governor Crow speak out on the desirability of having Ontario play a role (via fiscal policy) in curtailing aggregate excess demand. This is part of the underlying theme of this paper, namely that our macro authorities have failed to comprehend the full implications of globalization.

At this point it might be useful to look at this general issue from a quite different vantage point, namely that of the European Community and the experience with the European Monetary System, i.e., the currency "snake." Because the snake substantially reduces the flexibility of individual EC currencies, it embodies the same sort of issues alluded to above in the Canadian context. Consider, for example, the impact of yet a further increase in the German current account surplus triggered by, say, an export boom. The German mark vis-à-vis the U.S. dollar will rise to the top of the "snake" and then any further appreciation of the mark also implies an appreciation of the franc, the lira, etc. In other words, the mark's appreciation will fall short of a "market clearing" rate, which implies that the French and the Italians, etc., will end up with overvalued currencies. Thus, as a result of the operations of the snake, the German export boom creates unemployment in France and Italy. In balance of payments terms the German export surplus remains higher than would be the case if the mark was not part of the snake and this is offset by the fact that the French and Italians, etc., find their current account balances eroding. Needless to say, this is generating substantial concern in the EC.

One solution is to develop codes of conduct relating to national fiscal policy, particularly for surplus regions. Thus, if the Germans are experiencing increasing surpluses, their fiscal authorities would be expected to take some of the pressure off their economy. This is the direction that the European Community is heading in terms of handling the move towards relative fixity of exchange rates.

This is not quite the above case for provincial fiscal policy, but it is close. The Europeans are committed to relative fixity of exchange rates, and the fiscal rules mitigate the potential fallout from such a commitment. Any Canadian interest in more fixity of exchange rates within the FTA arises not from any such commitment but rather because the natural economic/trading relationships are both regional and cross-border, i.e., unlike the EC case, the driving force is economic integration not political or monetary union. In both cases, however, there are implications for the conduct of fiscal stabilization, particularly booming provinces/nations, within the free-trade bloc.

If relative exchange-rate fixity makes sense for the Europeans and more recently for the two Germanies, why do Canadian economists insist on a freely floating exchange rate as an integral component of the FTA?

The Bank of Canada's Policy

My final point relates to the on going stance of the Bank of Canada policy. The starting point is the aggregate savings identity. By the very way that we calculate national income, the sum of the government net savings plus private sector net savings plus foreign sector net savings must equal zero. In more familiar terms, this identity can be expressed as follows: the current account deficit must be equal to the difference between the government deficit and net private savings. The government deficit has remained at roughly $30 billion throughout the Mulroney mandate, although it has fallen substantially as a percent of GNP. However, Canadians are saving much less than they were earlier in the decade. Hence, our current account deficit has risen substantially.

There is no unique way to interpret these results. My interpretation runs as follows. The Bank's use of high interest rates to combat inflation runs up against the fact that about ½ of the federal debt is very short-term in nature (e.g., CSB's and treasury bills). Given that our debt is roughly $350 billion, a 1 percent increase in interest rates means that, in the long run, the interest cost of servicing the federal debt increases by $3.5 billion annually (assuming a 10 percent interest rate). Since roughly one-half of this appears within one year, given the 500 point differential between Canadian and U.S. short-term interest rates this implies a deficit increase somewhere in the $10 billion range. Thus, high interest rates increase the federal deficit which, when combined with falling savings rates, aggravates the existing domestic aggregate savings shortfall. These high interest rates draw in foreign capital to meet this shortfall. In turn, this inflow appreciates the exchange rate, which then generates the required (by the identity) current account deficit. In 1983 the current account registered a $3 billion surplus. By the end of last year, the current account was in deficit by some $20 billion.

Thus, in its attempt to combat inflation, the Bank of Canada is effectively decimating our tradeables sector in much the same way that U.S. policy did over 1983-85. Aggregate demand remains high because the decline in tradeables is offset by increased domestic consumption triggered by the larger deficit. Intriguingly, this erosion of the tradeables sector may make the Canadian economy more, not less, dependent on the existing level of the federal deficit. Moreover, the likelihood is that even higher real interest rates will be required in the future in order to attract this foreign capital, since Eastern Europe and in particular East Germany now have voracious appetites for foreign capital.

These high-interest-rate costs are much easier to accept if the end result is indeed lower inflation. The problem is that there is a possibility that the end result could well be higher inflation. Specifically, suppose the high interest-rate policy generates a policy-induced stagflation (a combination of high inflation or at least high interest rates and stagnation). The deficit will balloon on two counts — debt servicing on the one hand and a recession-induced collapse in revenues and increase in transfers on the other. The entire deficit reduction program of the past seven years will, as a result, be totally overwhelmed. We will be back in 1984 again, except that the domestic debt will have increased three-fold. At this point, the international capital markets are likely to lose faith in our economy or we may well attempt to inflate ourselves out of the fiscal debt and deficit overhang. In either case we would be in dire straights.

The basic problem is obvious. We have three macro challenges facing us. First, the enduring chestnut of inflation control. Second, the evolution of domestic aggregate savings shortfall that has led to the "twin-deficits" concern. Third, the likelihood that the appropriate exchange rate policy for the FTA may be one of much greater fixity than is generally anticipated. It is obvious that tighter fiscal policy is the key to the second of these problems. However, our macro managers were far too slow in reigning in the fiscal deficits so that we put excessive reliance on monetary policy and, in particular, high interest rates. Because of the short-term nature of our debt, this has had minimal impact on inflation since it was accompanied by a debt-servicing-induced increase in the deficit. Moreover, it has exacerbated the second and third of the above problems.

I am not claiming that monetary policy is unimportant. Far from it. But an excessive reliance on aggressive monetary policy cannot solve all of the above problems. Indeed, a single-minded pursuit of high interest rates is unlikely to solve *any* of them, at least not in a sustainable manner.

This, too, is an area where we Canadians and our macro managers in particular must rethink our traditional paradigms now that financial and real integration is a reality.

NOTES

1. See Torrance Wylie, "Multinationals vs. Transnationals," in Thomas J. Courchene (ed.) *Quebec Inc: Foreign Takeovers, Competition/Merger Policy and Universal*

Banking (Kingston: School of Policy Studies, Queen's University, 1990), pp. 26-27.

2. What follows with respect to Europe is really a supplement to the Sapir paper since he does not focus specifically on financial services. The ensuing analysis is basically "lifted" from the recent (1990) report of the Standing Senate Committee on Banking, Trade and Commerce (*Canada 1992: Towards A National Market for Financial Services*) for which I was a scribe.
3. Senate Standing Committee on Banking, Trade and Commerce (1990), *Canada 1992: Towards a National Market for Financial Services*, Eighth Report. This is also referred to as the Buckwold Report, after the Committee's Chairman, Senator Sidney L. Buckwold.
4. The remainder of the paper is adopted from a forthcoming manuscript (Courchene, 1990) from the C.D. Howe Institute.
5. Peter Druker, "The Changed World Economy," *Foreign Affairs* (Spring 1986), pp. 3-17.
6. In book value terms, the U.S. net debt is in the neighbourhood of a half-trillion dollars. However, in market value it is, in the current time, less than the market value of Canadian indebtedness. In a year or two, the U.S. net external debt will surpass Canada's net debt.
7. Thomas J. Courchene, "Rethinking the Macro Mix: The Case for Provincial Stabilization Policy," in Robert C. York (ed.), *Taking Aim: The Debate on Zero Inflation* (Toronto: C.D. Howe Institute, 1990).
8. Robert A. Mundell, "The Overvalued Canadian Dollar," paper prepared for the first meeting of the Canadian Monetary Policy Review Board, McGill University, Montreal, 1990.

Session I — Digest of Discussion

Discussion began with a preliminary comment from the chair regarding Courchene's earlier assertion that we need to redefine sovereignty. Germain Denis, drawing from his extensive experience in trade negotiations, offered to elaborate on this by saying that trade negotiators indeed "constantly redefine the exercise of sovereignty by accepting constraints."

The first question dealt with the matter of appropriate exchange rate policies in the context of globalization. Tom Courchene, while indicating that he did not particularly favour fixed exchange rates, believed that there were pressures that would nonetheless lead governments in that direction and indeed this had some merit. For example, a fixed exchange rate policy might provide the necessary fiscal discipline domestically in order that the Canadian rate of inflation could be kept down relative to the United States. Moreover, if the exchange rate continues to be driven by a "symbol" economy, the associated uncertainty in the investment climate might very well diminish the benefits of access gained under the FTA. In any event, Courchene felt that as north-south integration of the economy continues, the time has come to stop relying on the exchange rate to absorb all of the price shocks in the international economy and rather to focus on taking out the shock where it occurs. One possible instrument he suggested was provincial fiscal policy.

André Sapir contributed to the discussion by drawing attention to fundamental differences between the Canada-U.S. and West German-European Community relationships regarding exchange rates. In the latter case, West Germany has long been recognized as having a strict and responsible monetary policy. The perception among many EC countries is that West Germany could provide the necessary discipline or "anchor" in monetary policy for the rest of the Community. The Canada-U.S. context is somewhat different given the irresponsibility of U.S. monetary policy, according to Sapir. The problem for Canada, as he sees it, is that the country is so linked to the American dollar in terms of trade, while at the same time U.S. monetary policy continues to be very erratic.

Courchene elaborated on this comparative perspective by putting the two trading relationships into historical context. The major macro catastrophe in West German economic history was hyperinflation, while in Canada and the U.S. it was the Great Depression. Accordingly, in the former instance the tendency has been to err in favour of having more unemployment while in the latter case, the tendency has been to err in the sense of having more inflation. In the present context, Courchene questioned the wisdom of the Bank of Canada Governor Crow's zero-inflation policy given that the entire fiscal system of the federal government is geared towards 3 percent inflation. As well, he reiterated the need for rethinking the possibility of a federal-provincial secretariat on macropolicy.

A provincial government official queried Courchene as to whether provinces come up as winners or losers under the impact of globalization. In response, Courchene observed that many matters, which previously fell naturally in the provincial domain, are now probably being moved higher up because of internal economies, and it is possible that jurisdiction over provincial activities such as finance and telecommunications might be successfully challenged in the courts. In the particular case of the FTA, the provincial governments made something of a minor gain in that they were exempted from the obligations of Chapter 17 which dealt with financial services. Nonetheless, given that virtually everything is tradeable and mobile, all governments, federal and provincial, tend to lose.

A final question returned the discussion to the European context and centred on which school of thought on trade relations in the EC was winning out, the Euro-centrists or the internationalists. Sapir believed that the trend was towards the former school, supported primarily by a business constituency, and that this was giving rise to concern for politicians and negotiators in the current Uruguay Round. Of particular concern is the apparent disinterest of this constituency in developing trade relations with the developing countries, save for East Asia and now Eastern Europe. Traditionally, West Germany has had much stronger ties to East Asia relative to other European countries (e.g., automobile industry) and can be relied upon to do something there. However, it is questionable whether this will remain a priority if the same benefits can be gained from Eastern Europe with less effort. As for the multilateralists such as the EC Commissioner and various politicians who take a much longer-term and more global approach, the onus is on them to convince the business constituency that it is dangerous to take a short-term, Euro-centred view.

II

The Canadian Constitution and International Economic Relations

The Canadian Constitution and International Economic Relations

Robert G. Richards

A discussion of the Canadian response to global economic challenges must include some consideration of our constitutional framework. The division of powers in the constitution prescribes the basic authority of Parliament and the provincial legislatures. It has obvious implications for the capacity of both Canada and the provinces to pursue their economic agendas.

In recent decades, the ability of Parliament to advance its economic initiatives has not been significantly hampered by the limitations on its power imposed by the constitution.[1] The federal government has relied largely on Keynsian policy instruments to manage the economy. Taxation, monetary policy and spending are all securely within the federal legislative domain. In the area of international trade, tariffs were the main policy concern. They are also squarely within federal jurisdiction.[2]

However, we have moved into a realm where the jurisdictional limits imposed by the constitution are of increasing significance to policy-makers. The globalization of the economy and the growing preoccupation with international trade matters has given prominence to a new set of economic issues. In the trade area specifically, expanded attention to matters like nontariff barriers, subsidies, services and social programs invite Ottawa to push the edges of its established constitutional power. In the realm of general economic management, notions like "industrial strategies" and free trade do the same. In short, there is likely to be a continuing set of issues that will raise questions about the lines between federal and provincial jurisdiction.

I have been asked to address possible new trends and directions in the constitutional doctrine relating to international economic relations. In that light, I want to focus briefly on two features of the constitution that merit special consideration: (a) the so-called treaty power, and (b) the trade and commerce power. I propose to discuss each of these matters in turn.

Treaties

The constitution contains no express grant of authority to make treaties. The conduct of foreign affairs, including the negotiation of treaties, is a prerogative of the Crown. It is reasonably well-settled that this power vests exclusively in the Crown in right of Canada, i.e., the federal government.[3] Canada has a full and plenary power to negotiate and conclude treaties. The provinces do not enjoy such power.

However, under Anglo-Canadian law, treaties are not self-executing. They do not automatically become the law of the land. Legislative action is necessary to implement a treaty that affects the rights of private citizens, involves the expenditure of money or requires the alteration of existing domestic law. That requirement poses no unusual difficulty in a unitary state such as the United Kingdom where there is only one legislature. But in a federal state like Canada, there is a question about which level of government should enjoy powers of implementation.

There is a provision in the constitution that speaks to the implementation of treaties. Section 132 of the *Constitution Act, 1867* says that Parliament and the Government of Canada have all powers necessary to implement "British Empire" treaties. The section reads as it does because, in 1867, the British government negotiated, signed and ratified all treaties applicable to the Empire. The development of Canada from colony to independent state was not foreseen. Therefore, the constitution made no accommodation for that evolution.

Once Canada obtained the power to conclude treaties on its own behalf, the question arose as to whether Parliament's power to implement "Empire" treaties could be read as allowing it to implement Canadian treaties. That question was answered in the *Labour Conventions*[4] case of 1937. The Privy Council held that there was no treaty-implementing power per se. The authority to implement a treaty was to be determined by reference to the catalogue of powers in sections 91 and 92 of the *Constitution Act, 1867*. Parliament could legislate as required if the implementing statute related to a matter under federal authority. But, if the statute related to a provincial matter, then the provinces would have to implement the treaty.

The main implication of the *Labour Conventions* ruling for Parliament is rather obvious. The case denies Ottawa plenary power in matters relating to treaties. Thus, to the extent the federal government pursues international economic strategies that involve treaty arrangements, there is a possibility that it will be frustrated by an inability to fully perform its obligations. That restriction might hamper Canada's capacity to be an effective player in the international arena, and consequently to manage domestic economic affairs.

However, three moderating considerations must be borne in mind when assessing the overall significance or merit of the *Labour Conventions* approach:

1. It is easy to overstate the problems that flow from the *Labour Conventions* case. A number of key subject matters are within exclusive federal jurisdiction. There will never be any problem implementing a treaty that relates to those areas. Further, treaties dealing with matters under provincial control can be implemented with provincial cooperation. That cooperation can significantly reduce the potential negative consequences of the *Labour Conventions* doctrine.
2. A plenary federal treaty implementation power could seriously undermine the overall balance between federal and provincial authority. International agreements now are being concluded in a very broad range of areas, many of which are deep within provincial legislative territory. Thus, Ottawa could significantly erode provincial authority if it had the power to automatically implement all treaties. Moreover, a federal treaty implementation power would allow Ottawa to expand or contract provincial jurisdiction on its own initiative.
3. The bifurcated treaty power encourages Ottawa to be sensitive to provincial and regional needs in its policy formulation. It is much easier to forget the full range of interests in the country if there is no obligation to consider provincial roles in an implementation strategy. The history of the negotiation of the Free Trade Agreement confirms the point.

The *Labour Conventions* decision has been heavily criticized by academic commentators. On several occasions,[5] the Supreme Court of Canada has hinted that it may be prepared to reopen the *Labour Conventions* debate. Thus, a reconsideration of the treaty power is a clear possibility and deserves consideration.

I do not believe that the Supreme Court, if it does revisit the treaty issue, will go so far as to recognize a general or plenary federal treaty implementing power. The Court is sensitive to the need to maintain a balance between federal and provincial authority. A plenary federal treaty implementing authority could upset that balance in short order. In my view, the Supreme Court will avoid conferring such an open-ended power on Parliament.

My thinking in that regard is bolstered by the 1988 *Crown Zellerbach*[6] decision. In that case, the Supreme Court undertook a comprehensive review of Parliament's peace, order and good government power and enumerated the basic principles that govern its operation and application. The ruling is relevant to the present discussion because a revitalized federal treaty power would be based on POGG.

In *Crown Zellerbach*, the majority of the Court held that the so-called "national concern" doctrine of POGG can bring under federal authority new matters that did not exist at Confederation and matters ordinarily within provincial authority that have become matters of national concern. The Court said that, for a matter to qualify as one of national concern, it must have a "singleness, distinctiveness and indivisibility that clearly distinguishes it from matters of provincial concern" and, as well, must have a scale of impact on provincial jurisdiction that is reconcilable with the fundamental distribution of legislative power under the constitution.[7]

In my judgement, a plenary federal treaty implementation power would not satisfy that last requirement. It would be an effectively unlimited authority and not reconcilable with the basic allocation of legislative authority between Parliament and the provincial legislatures.

Therefore, a revision of the treaty power is more likely to result in a limited or circumscribed federal power to implement treaties within areas of provincial responsibility. There are several possibilities.[8] For example, the Court could develop a doctrine whereby the existence of the treaty would be a key consideration in deciding whether a matter had acquired sufficient national importance to come under the POGG power. This would allow federal regulation of ordinarily provincial matters, not because of the treaty per se, but because national regulation is necessary. The treaty would merely help to confirm the existence of that necessity. Alternatively, the Court could hold that the existence of a treaty obligation will be relevant to the application of the "necessarily incidental" doctrine. On that basis, the treaty could be used to bolster the validity of those pieces of a federal legislative package that would ordinarily be seen as being within provincial jurisdiction. There are, of course, other alternative approaches that could be adopted as well.

In summary, a reconsideration of the federal treaty implementing power is a real possibility. However, any such reconsideration is unlikely to result in a radical or open-ended redefinition of federal authority in this area.

Trade and Commerce

The other feature of the constitution which warrants comment is the authority of Parliament in relation to "trade and commerce" as provided in section 91(2) of the *Constitution Act, 1867*. There have been important recent developments in the interpretation of that power.

On its face, "trade and commerce" has enormous breadth. It could embrace almost any kind of economic activity. Historically, that potentially broad scope has been limited by the courts in order to protect provincial autonomy and a balanced federalism. Judges recognized that a broad reading of section 91(2) could result in trade and commerce subsuming significant areas of provincial jurisdiction. Over the years, there has been an attempt to circumscribe the trade and commerce power in a way that protects its integrity but that does not unduly displace provincial jurisdiction in relation to property and civil rights.

The famous *Parsons*[9] case in 1881 defined the trade and commerce power as having two branches: the first involves interprovincial and international trade; the second is the so-called general power. It concerns, in the words of the Privy Council, "general regulation of trade affecting the whole Dominion." Obviously, the international trade wing of section 91(2) is not uninteresting or insignificant for purposes of examining federal jurisdiction in relation to a globalized economic environment.[10] However, the most interesting developments are occurring in relation to the general power.

Following *Parsons*, the courts dutifully bowed in the direction of the general power but did not rely on it with regularity. Indeed, until last year, it had been invoked only twice by final appellate courts to sustain federal legislation. By 1980, there were some indications that the general power was drawing its last breath. Following two Supreme Court decisions rendered at that time, one commentator speculated that the general power "might well be extinct."[11]

However, in the 1983 *CN Transportation* case,[12] the pendulum began to swing back in favour of the general power. In that decision, the Chief Justice, and two of his brother judges, indicated that they were prepared to uphold a section of the *Combines Investigation Act* under the general wing of section 92(2). Chief Justice Dickson canvassed the history and nature of the general power in some depth and laid out a number of criteria for determining its proper application. At the time, it was clear that *CN Transportation* represented an important commitment to resuscitate the general power.

That resuscitation was realized in 1989. In the *General Motors*[13] decision, a unanimous Supreme Court upheld the *Combines Investigation Act* under the general wing of section 91(2). It laid out five indicia of the valid exercise of the general power:

- The legislation must be part of a general regulatory scheme.
- The scheme must be monitored by a regulatory agency.
- The legislation must be concerned with trade as a whole rather than with a particular industry.
- The legislation should be of a nature that the provinces jointly or severally would be constitutionally incapable of enacting.

- The failure to include one or more provinces or localities in a legislative scheme would jeopardize the successful operation of the scheme in other parts of the country.

The Court emphasized, however, that this list was not exhaustive and that the presence or absence of any of the criteria was not determinative.

There is no doubt that the *General Motors* decision signals the possibility of some significant realignments in the relationship between federal and provincial governments. The revitalization of the trade and commerce power was deliberate. It no doubt reflects a concern that Parliament must have the tools necessary to manage the national economy.

However, at the same time, *General Motors* itself has not ushered in a new regime of federal economic hegemony. The Court made it very clear that the question of constitutional balance underpins the entire consideration of the general power. It stressed that section 91(2) must not be read so as to upset the balance between the federal and provincial governments. It reaffirmed that there was no federal power to regulate a single trade or business. And, it indicated that issues involving the general power must be determined on a careful case by case basis.

Thus, while the developments with respect to section 91(2) are obviously important, I think that the Supreme Court will proceed carefully in this area. It will be pragmatic and will examine each federal legislative initiative largely on its own merits. It will be loathe to endorse anything dramatic unless the initiative clearly responds to a pressing need in the national economy.

Conclusion

In conclusion, there are some definite prospects for expanded federal power in the realm of international trade and economic management. The Supreme Court is not in a position to disregard entirely the changing character of the Canadian and global economies. However, overall, I expect that the Court will strive to make changes incrementally rather than radically. It is sensitive to the issue of national economic management, but it is obviously loathe to sharply alter the balance of federalism.

It should also be noted that neither level of government will be quick to resolve jurisdictional controversies in the courts. The litigation process is neither timely nor predictable. Both Ottawa and the provinces will continue to employ political and bureaucratic processes as the preferred vehicles for dispute resolution in this area. That tendency to avoid litigation also will limit the possibility of decisions that could formally adjust the constitutional alignment.

NOTES

1. Ottawa's experiment with wage and price controls in the 1970s is the notable exception. Nonetheless, the constitutional issue was ultimately resolved in favour of Parliament. See: *Anti-Inflation Reference*, [1976] 2 S.C.R. 373.
2. See Whyte, "Federal Powers Over the Economy: Finding New Jurisdictional Room," 13 Canadian Business Law Journal, 157 at 268-9.
3. See: *Newfoundland Off Shore Reference*, [1984] 1 S.C.R. 86.
4. *A.G. Canada* v. *A.G. Ontario*, [1937] A.C. 326.
5. See, for example: *Schneider* v. *The Queen*, [1982] 2 S.C.R. 112 at 134-5; *MacDonald* v. *Vapour Canada Ltd.*, [1977] 2 S.C.R. 134 at 162-172.
6. *R.* v. *Crown Zellerbach*, [1988] 1 S.C.R. 401.
7. Ibid, at 432.
8. See generally, LaForest, "The Labour Conventions Case Revisited" (1974), 12 Canadian Yearbook of International Law 131; R. Sullivan, "Free Trade With the United States: The Constitutional Framework," presented at the Conference on Canada-United States Trade Negotiations, 8-9 May 1986.
9. *Citizens' Insurance Co.* v. *Parsons* (1881), 7 App. Cas. 96.
10. The possibility of the Supreme Court reconsidering its rather formalistic approach to the scope and content of international and interprovincial trade is the key matter of significance. See Whyte, op. cit. at 284-7.
11. MacPherson, "Developments in Constitutional Law: The 1979-80 Term," 2 Supreme Court LawReview, 49 at 71.
12. *A.G. Canada* v. *Canadian National Transportation Ltd.*, [1983] 2 S.C.R. 206.
13. *General Motors of Canada Ltd.* v. *National City Leasing*, [1989] 1 S.C.R. 641.

L'impact de l'internationalisation sur le fonctionnement de l'état: le partage constitutionnel des compétences

Ivan Bernier

Le 17 mai 1990, la société Heileman Brewery Inc., des États-Unis, déposait une plainte auprès du Représentant américain au commerce, suivant la procédure de l'article 301 du *Trade Act of 1974*, tel qu'amendé par l'*Omnibus and Competitiveness Act of 1988*, laquelle plainte portait sur les agissements des monopoles provinciaux des alcools au Canada en matière de vente et de distribution de bières importées. Le 30 juin 1990, cette plainte était acceptée par le Représentant américain au commerce qui faisait part de son intention de poursuivre une enquête plus poussée en même temps que des démarches étaient entreprises en vue de porter le problème devant les Parties contractantes du GATT. Ce dernier épisode dans le débat qui oppose depuis longtemps déjà le Canada aux États-Unis et à la Communauté européenne sur le sujet du fonctionnement des monopoles provinciaux des alcools illustre on ne peut mieux le dilemme d'un pays comme le Canada qui doit composer avec l'existence d'États membres dotés d'une large autonomie et répondre internationalement de leurs agissements, tout en étant amené à s'engager toujours plus avant dans un monde qui s'internationalise de plus en plus[1].

Cette internationalisation est particulièrement manifeste dans le domaine de l'économie. Il ne se passe pratiquement pas de jours, en effet, sans que l'on n'entende parler d'internationalisation de la production, de globalisation des marchés, etc. Du discours à la réalité, on s'en doute bien, il y a une certaine démarcation. C'est ainsi que si la globalisation des marchés est devenue une réalité dans le domaine financier, il n'en va pas tout à fait de même dans le domaine des échanges de biens et de services où persistent encore de nombreuses entraves aux échanges. Milton Friedman avançait, il y a quelque temps, que l'internationalisation de l'économie n'était pas si évidente lorsqu'on la mesurait à partir d'un indicateur tel que la tendance à l'égalisation des prix sur le marché mondial[2]. Il n'en reste pas moins qu'aux yeux de la vaste majorité des observateurs, cette internationalisation, si elle n'est pas quelque chose d'achevé comme le suggérait la démarche de Friedman, est un phénomène en voie de réalisation qui se traduit non seulement par un accroissement régulier des échanges internationaux mais également, et de façon parallèle, par la mise en place de régimes juridiques divers qui se veulent de plus en plus contraignants pour les États.

Dans le cas des États fédéraux comme le Canada, ce dernier développement prend une signification particulière du fait du partage constitutionnel des compétences. Il est ressenti d'abord au niveau des instances centrales qui sont amenées graduellement à s'engager au plan international dans des domaines de plus en plus diversifiés et, ce qui n'est pas pour simplifier les choses, dans des domaines qui relèvent de plus en plus fréquemment de la compétence des provinces. C'est ainsi que dans les présentes négociations de l'Uruguay Round, le GATT, en plus de se pencher sur les obstacles tarifaires et non-tarifaires aux échanges de biens, a ajouté des sujets nouveaux de discussion tels que les services, l'investissement et la propriété intellectuelle; et si l'on se fie à la tendance qui s'est manifestée lors du Tokyo Round, il y a fort à parier que les solutions avancées viseront aussi bien les interventions fédérales que provinciales. Or, malgré la division interne des compétences qui le caractérise, le Canada n'a pas le choix : il doit intervenir dans les discussions, prendre position et, s'il veut obtenir des compromis des autres parties contractantes, doit lui-même envisager de faire des concessions. Dans de telles conditions, on comprendra que les instances fédérales ne peuvent faire autrement que se sentir gêner par le partage fédéral des compétences.

Il y a aussi un impact du côté des instances provinciales qui voient leur champs de compétences de plus en plus touchés par des négociations qui se font largement en dehors d'elles et sur lesquelles elles n'exercent, individuellement ou collectivement, aucun contrôle. Or ceci est d'autant plus difficile que les impacts économiques résultant de tels arrangements internationaux se font sentir directement sur leur territoire. Lorsque les ajustements exigés par de nouveaux engagements commerciaux internationaux se traduisent par des fermetures d'usines et des pertes d'emplois, ces instances provinciales doivent en répondre vis-à-vis des électeurs pratiquement au même titre que les instances fédérales, et ce même si elles ne sont pas directement impliquées dans les développements en question. L'insatisfaction de l'électorat dans le domaine politique ne suit pas si étroitement le partage des compétences constitutionnelles.

Deux approches sont possibles pour résoudre ce dilemme, lesquelles, sans être totalement exclusives, tendent malgré tout à s'opposer. La première est l'approche juridique, davantage encline à trancher le débat en établissant une ligne de démarcation claire entre les intérêts nationaux et les intérêts régionaux. Elle procède soit par la voie d'amendements formels à la constitution, soit par la voie plus détournée des décisions judiciaires. La seconde est l'approche politique, orientée plutôt vers des solutions de compromis; elle se traduit plus souvent qu'autrement par la mise en place de mécanismes de contacts et de collaboration. On ne se surprendra pas de constater que chez les juristes, particulièrement chez les juristes du Canada anglais, la solution préférée va dans le sens d'une interprétation élargie du pouvoir fédéral dans le domaine économique en général, surtout lorsqu'il est question de mise en oeuvre d'engagements économiques internationaux[3]. La classe politique, pour sa part, évite de trancher lorsqu'elle n'a pas à le faire, recherche le compromis; mais celui-ci, règle générale, n'apparaît acceptable aux instances fédérales comme aux instances provinciales que s'il n'implique pas de pertes de pouvoir. Cette démarche de négociation s'accompagne donc fréquemment de références au partage constitutionnel des compétences, chaque partie cherchant à interpréter celui-ci en sa faveur. Est-ce parce que l'on ne s'entend pas sur le sujet que les efforts entrepris depuis plus d'un an en vue de mettre sur pieds une structure permanente de concertation fédérale-provinciale en matière de commerce international n'ont pas aboutis[4]? Si tel est le cas, alors il apparaît urgent de clarifier la situation.

Il n'est pas de mon intention ici de repasser l'ensemble des règles qui président au partage des compétences dans le domaine économique en général, même si la globalisation des marchés se trouve à soulever indirectement la question de la capacité de l'État canadien de faire face de la manière la plus efficace à la concurrence accrue qui se manifeste au plan international. Certes il est possible de penser que le partage actuel n'est pas le plus propice à une action décisive du Canada en vue de s'ajuster à ce nouveau contexte international. Mais si l'on pousse le moindrement dans cette direction, on peut facilement aboutir à la conclusion que la structure fédérale même du Canada constitue un obstacle qui devrait être éliminé. Plutôt donc que d'avancer ma propre hypothèse sur le régime idéal de partage des compétences économiques susceptible de faciliter l'adaptation du Canada au nouveau contexte de la globalisation des marchés, je vais m'en tenir au problème plus immédiat et plus concret de l'étendue de la compétence du Parlement fédéral en ce qui concerne la mise en oeuvre des engagements commerciaux internationaux. Pour y voir plus clair, je parlerai d'abord de la compétence de principe du Parlement fédéral en matière de commerce international pour ensuite m'arrêter au problème, beaucoup plus difficile, de définir ce qui entre sous le vocable de « commerce international ».

La compétence de principe du Parlement fédéral en matière de commerce international

On peut tenir pour acquis au départ que l'exécutif fédéral a toute compétence pour s'engager au plan international, sans égard au partage des compétences. Ceci est confirmé par la jurisprudence et aucun auteur de droit constitutionnel ne prétend sérieusement le contraire[5]. Je laisse de côté ici la question de la compétence concurrente des provinces de s'engager internationalement dans les domaines de leur compétence, qui demeure une question controversée au plan théorique, particulièrement lorsque vient le temps de qualifier la nature juridique de tels engagements, mais qui est une question dépassée dans les faits, les provinces n'ayant pas hésité à aller de l'avant[6].

S'agissant en revanche de la compétence du Parlement fédéral de mettre en oeuvre les engagements du Canada dans le domaine économique international, la situation est un peu plus complexe. Même s'il a souvent été question de ce problème depuis quelques années, particulièrement lors des débats qui ont accompagné la négociation et la mise en oeuvre de l'Accord de libre-échange entre le Canada et les États-Unis, il apparaît important d'y revenir, car ce dernier a trop souvent été traité comme si on voulait régler l'ensemble des problèmes du Canada dans le domaine économique.

La seule disposition de la Constitution qui parle de mise en oeuvre des traités concerne les traités de l'empire britannique et est maintenant désuète. Comme il fallait s'y attendre, toutefois, les tribunaux ont eu l'occasion de se pencher sur la question et ont de fait adopté une solution qui a régulièrement été critiquée depuis. La décision qui s'impose à l'heure actuelle, et jusqu'à ce qu'il en soit décidé autrement, est celle du Conseil Privé dans l'*Affaire des conventions du travail*[7]. Cette décision est à l'effet que la mise en oeuvre des traités relève de l'autorité compétente constitutionnellement pour légiférer dans le ou les domaines couverts par ceux-ci. Ainsi, dans les champs de compétence appartenant en exclusivité aux provinces, il reviendrait à celles-ci de mettre en oeuvre les accords conclus par l'exécutif fédéral. Certains auteurs, prenant appui sur des opinions accessoires émises par la Cour suprême du Canada, suggèrent que le temps est venu pour cette dernière de renverser la décision rendue dans l'*Affaire des conventions du travail* et de décréter qu'à l'avenir le Canada aura toute compétence pour mettre en oeuvre les traités qu'il signe, quelque soit le domaine couvert[8]. Mais cette opinion demeure minoritaire et il y a tout lieu de croire que la Cour suprême, qui a toujours cherché à éviter dans le passé un déséquilibre du fédéralisme canadien et a souvent répété que certains problèmes devaient trouver leur solution dans la coopération intergouvernementale, n'ira pas dans cette direction sans établir des balises précises au pouvoir de mise en oeuvre des traités du fédéral.

Ceci étant dit, le point de départ pour la solution de notre problème devient évident : pour savoir de qui relève la mise en oeuvre des traités commerciaux du Canada, il faut avant tout déterminer de qui relève, aux termes de la constitution, le domaine général du commerce international. La réponse à cette question encore une fois a été apportée par les tribunaux. Dans l'Affaire *Citizen Insurance c. Parsons*,[9] qui remonte à 1881, le Conseil privé jugeait inconstitutionnelle une loi fédérale sur les assurances qui prétendait réglementer, sous le couvert du commerce international, le domaine de l'assurance en général. Le Conseil privé, à cette occasion, avait eu à interpréter l'article 91(2) de l'*Acte constitutionnel de 1867* qui accorde au Parlement fédéral une compétence exclusive sur les échanges et le commerce. Après avoir établi que ces deux derniers termes, s'ils étaient interprétés dans leur sens le plus large, aboutissaient à nier d'autres pouvoirs reconnus aux provinces, il énonça une distinction qui a toujours cours maintenant. Se fondant entre autres sur le sens donné aux mêmes termes dans l'Acte d'union entre l'Angleterre et l'Écosse, le Conseil privé détermina que ce qui relevait à proprement parler de la compétence fédérale aux termes de l'article 91(2) était, d'une part, la réglementation du commerce interprovincial et international et, d'autre part, la réglementation du commerce en général. Aux législatures provinciales appartenait en exclusivité, par ailleurs, la réglementation du commerce intraprovincial. La réponse de principe au problème que nous avons soulevé au départ donc est claire : le Parlement fédéral a toute la compétence voulue pour mettre en oeuvre les traités qu'il conclut dans le domaine du commerce international. Cette compétence, en vertu de la règle de la prépondérance fédérale, va jusqu'à permettre une intrusion dans les champs de compétence provinciale lorsque celle-ci s'avère essentielle à l'exercice de la compétence fédérale sur le commerce international.

Compte tenu de ce qui vient d'être dit, il apparaît pour le moins curieux que les auteurs favorables à un élargissement de la compétence fédérale en matière de mise en oeuvre des traités commerciaux du Canada utilisent essentiellement l'argument de la compétence fédérale sur la réglementation du commerce en général pour justifier une telle extension de compétence[10]. Le fait est que depuis l'important *dictum* du juge Dickson dans l'arrêt *Transport nationaux*,[11] c'est la voie qui est considérée comme la plus prometteuse pour étendre de façon sensible la compétence du Parlement fédéral dans le domaine économique en général. Les deux critères les plus importants de la validité d'une loi fédérale qui réglementerait l'économie de façon générale sont, pour le juge Dickson : 1) que la Constitution n'habilite pas les provinces, conjointement ou séparément, à adopter une telle loi; 2) que l'omission d'inclure une seule province ou plusieurs provinces et localités compromettrait l'application de ladite loi dans d'autre parties du pays. Toutefois, il m'apparaît que le recours à cet argument pour justifier la compétence du Parlement fédéral de mettre en oeuvre des traités commerciaux internationaux est à la fois déplacé et dangereux. Déplacé, d'abord, parce qu'un tel recours est inutile vu la compétence reconnue du Parlement fédéral sur le commerce international. Dangereux, ensuite, parce que la logique qui sous-tend l'argumentation fondée sur la réglementation du commerce en général répond à des considérations essentiellement internes et vise un problème autre que celui de la réglementation du commerce international. Lorsque la Cour suprême du Canada s'est prononcée sur ce pouvoir fédéral de réglementation du commerce en général, en effet, elle l'a fait en cherchant à éviter en particulier que la gestion économique du Canada se trouve négativement affectée du fait que certaines activités se retrouvent en porte-à-faux par rapport au partage des compétences. La compétence fédérale sur le commerce international, quant à elle, est claire et soulève essentiellement un problème de qualification de l'activité visée, toute activité comportant à la limite une dimension internationale. Pour répondre adéquatement à ce problème, il faut l'aborder, croyons-nous, dans une logique de commerce international et non pas dans une logique de gestion interne de l'économie.

Le commerce international en tant que domaine d'activité

À ce jour, il ne paraît pas que les tribunaux canadiens se soient posé la question de savoir ce qu'il fallait entendre par commerce international, soit que la chose leur sembla évidente, soit qu'aucune occasion ne se soit présentée de statuer sur le sujet. Or, s'il est vrai que la réglementation du commerce international s'est longtemps résumée à une simple question de droit de douane et, à l'occasion, de quota — la notion de barrières non-tarifaires aux échanges n'est apparue que relativement récemment —, il n'en va plus du tout de même de nos jours où pratiquement toute intervention de l'État est susceptible d'être considérée comme une telle barrière. Pour ce qui est des occasions, par ailleurs, nous sommes venus bien près d'en avoir une, en 1975, lorsque le gouvernement de l'Ontario a mis de l'avant un plan de remise de taxe de vente sur les automobiles fabriquées en Amérique du Nord, lequel entraîna immédiatement une vive réaction des pays fabricants exclus du bénéfice de cette mesure[12], ou plus récemment, en 1988, lorsque la même province menaça de porter devant les tribunaux la question de l'étendue de sa compétence sur le commerce des boissons alcooliques en réaction aux engagements pris par le gouvernement fédéral dans le domaine des alcools dans le contexte du GATT et de l'Accord de libre-échange entre le Canada et les États-Unis. Un jour ou l'autre, manifestement, une réponse devra être apportée à cette question.

Même si, jusqu'à maintenant, le gouvernement fédéral et les gouvernements des provinces ont soigneusement évité de soumettre la question aux tribunaux, rien ne garantit qu'il en sera de même dans le futur. Surtout, rien n'empêche une partie privée impliquée dans un litige de soulever le problème en fonction de ses propres intérêts en faisant valoir, par exemple, qu'une législation provinciale qu'elle conteste outrepasse les compétences des provinces parce qu'elle touche à une question de commerce international. Les tribunaux alors n'auront plus le choix : ils devront se prononcer. Et une ligne de démarcation devra être tracée.

À défaut d'un critère clair établi par les tribunaux, je voudrais ici avancer une hypothèse qui me semble convenir à la solution de ce problème, une hypothèse qui emprunte essentiellement à l'esprit et à la logique de la réglementation internationale du commerce. En se fondant sur ce qui est l'objet premier de pratiquement toute réglementation internationale sur le commerce, à savoir l'élimination des mesures qui instituent des entraves à la circulation des échanges, on pourrait avancer, par exemple, que toute législation provinciale qui, directement ou indirectement, en fait ou en puissance, discrimine à l'encontre des biens ou des services étrangers doit être présumée outrepasser les compétences des provinces et viser le commerce international. Cette présomption, toutefois, se trouverait renversée dans certains cas exceptionnels clairement identifiés, comme lorsqu'il s'agit par exemple de mesures nécessaires à la protection de la moralité publique, à la protection de la santé et de la vie des personnes et des animaux ou à la préservation des végétaux, ou se rapportant encore à la protection de ressources naturelles épuisables, à condition que ces dernières mesures ne constituent pas une restriction déguisée au commerce international et pour autant évidemment que les provinces soient autrement compétentes pour légiférer en la matière. Dans le cas d'une réglementation provinciale qui restreint la libre circulation des biens et des services de façon générale, sans être pour cela discriminatoire, formellement ou substantiellement, la présomption jouerait dans le sens inverse, c'est-à-dire que la disposition en question serait présumée valide; mais cette dernière présomption pourrait elle-même être renversée s'il devait être établi qu'il y a disproportion entre les moyens utilisés et les buts poursuivis, en d'autres termes si elle ne satisfaisait pas à un critère de raisonnabilité et de proportionalité.

Une telle approche est non seulement dans l'esprit général du GATT[13], mais elle reproduit pour l'essentiel la position développée par la Cour de justice des Communautés européennes dans le but de distinguer ce que le Traité de Rome décrit comme des mesures d'effet équivalent à des restrictions quantitatives, interdites aux États membres, des autres mesures adoptées par ces derniers dans le but de discipliner le commerce des biens et services sur leur territoire, même si ces mesures peuvent avoir à l'occasion une incidence sur l'importation des marchandises en provenance des autres pays[14]. Il est intéressant de noter également que la toute première décision rendue sous le chapitre 18 de l'Accord de libre-échange entre le Canada et les États-Unis, celle concernant le saumon et le hareng du Pacifique, reprend jusqu'à un certain point cette approche[15].

Toujours dans le cadre de la réglementation du commerce international, on constate qu'au-delà de l'élimination des entraves volontaires aux échanges de biens et de services, un autre objectif fréquemment poursuivi est l'harmonisation — on ira même parfois jusqu'à parler d'uniformisation — de normes nationales qui, du seul fait de leur diversité, ont un effet limitatif sur les échanges. Dans le jargon communautaire européen, on parlera alors d'intégration positive, par opposition à l'intégration négative qui, elle, fait référence à l'élimination des obstacles volontaires aux échanges[16]. L'intégration positive, faut-il le préciser, ne procède jamais par voie judiciaire mais plutôt par voie de consensus, ou encore, dans un contexte plus intégré comme celui de la Communauté économique européenne, par décision majoritaire. S'il fallait que les tribunaux canadiens transfèrent au Parlement fédéral le pouvoir de mettre en oeuvre tout accord commercial incorporant un tel processus d'intégration positive, sans égard aux compétences des provinces, ils se trouveraient à ouvrir la porte à une modification substantielle du partage des compétences, en l'absence de tout assentiment des provinces. Le problème est si réel d'ailleurs que les négociateurs de l'Accord de libre-échange Canada/États-Unis ont tout bonnement convenu d'exclure les provinces et les États de l'application de son chapitre 6 sur l'harmonisation des normes[17]. Aussi croyons-nous que pour l'interprétation de la notion de commerce international, nos tribunaux devraient considérer différemment les normes d'intégration négative et les normes d'intégration positive, ces dernières impliquant un choix auquel les provinces doivent être associées pour autant qu'elles sont concernées.

Conclusion

Ce qui est suggéré ici vise évidemment le futur. Mais l'analyse qui précède peut-elle encore tenir, maintenant que le Canada se trouve plongé dans une crise politique profonde qui remet en cause, à la limite, son intégrité même? En dehors de l'hypothèse de l'indépendance pure et simple du Québec, il y a fort à parier que toute solution impliquant le maintien d'une union douanière, et *a fortiori* d'une union économique, avec le reste du Canada continuera de soulever le même problème de mise en oeuvre des traités commerciaux internationaux et appellera sensiblement le même type de réponse. Les contraintes, nous l'avons vu, sont d'origine externe et ne s'estomperont pas de sitôt.

L'intégration négative en particulier, celle qui vise à l'élimination des entraves aux échanges, se présente de moins en moins comme une question de choix; bien davantage, elle apparaît comme une donnée fondamentale de l'internationalisation de l'économie. Aussi le fait qu'elle n'ait pas encore été totalement réalisée au Canada prend-t-il de plus en plus l'allure d'un anachronisme. L'intégration positive, quant à elle, demeure une question de choix. Reste à voir si celui qui avait été fait dans l'*Acte constitutionnel de 1867* demeurera.

NOTES

1. Voir, sur l'ensemble de ce contentieux relatif au fonctionnement des monopoles provinciaux des alcools, I. Bernier et A. Binette, *Les provinces canadiennes et le commerce international. Dynamique économique et ajustement juridique*, Québec, Centre québécois de relations internationales et L'Institut de recherches politiques, 1988, pp. 52-55 et 135-138.
2. M. Friedman, "Evidence Shows the 'Internationalized' Economy is Nonsense", *The Globe and Mail*, 6 mai 1989, p. B-2.
3. Voir, entre autres, les dépositions de G. Morris et de S. Fairley devant le Comité des Affaires étrangères du Sénat du Canada lors des débats entourant la négociation de l'Accord de libre-échange Canada/Etats-Unis, Sénat du Canada, *Délibérations du Comité sénatorial des Affaires étrangères*, 4 mai 1988, fascicule No 21, Voir également R.E. Sullivan, "Jurisdiction to Negotiate and Implement Free Trade Agreements in Canada: Calling the Provincial Bluff", 24 *University of Western Ontario Law Review*, pp. 53-82.
4. "Ottawa veut agir seul pour implanter le libre-échange", *Le Devoir*, 18 avril 1989.
5. Voir I. Bernier et A. Binette, *supra* note 1, p. 190.
6. Il existe plusieurs études qui traitent de l'activité internationale des provinces. Plutôt que d'en faire un relevé ici, nous référons le lecteur à deux ouvrages collectifs qui traitent de façon générale du développement de l'activité internationale des entités non-souveraines: voir en particulier I.D. Duchacek, D. Latouche et G. Stevenson, *Perforated Sovereignties and International Relations. Trans-Sovereign Contacts of Subnational Governments*, New York, Westport Connecticut, London, Greenwood Press, 1988; voir également le numéro spécial de la revue *Publius* sur le même sujet, Volume 14, No 4, 1984.
7. *Procureur général du Canada c. Procureur général de l'Ontario*, (1937) A.C. 326.
8. Voir en particulier Morris, *supra* note 3.
9. (1881) 7 A.C. 96.
10. Voir en particulier à ce sujet J.D. Whyte, "Federal Powers over the Economy: Finding Nzw Jurisdictional Room" (1987-1988), 13 *Canadian Business Law Journal/ Revue canadienne du droit de commerce*, pp. 257-312.
11. *Procureur général du Canada c. Transports nationaux du Canada* (1983), 2 R.C.S. 206.

12. Sur cet épisode en particulier, voir P. Gusen, *The Role of Provincial Governments in Economic Stabilization: The Case of Ontario's Auto Sales Rebate*, Ottawa, Conference Board, 1978.
13. En ce sens, voir la récente décision à l'encontre du Canada dans l'affaire des *Mesures affectant l'exportation de harengs et de saumon non préparés*, GATT, I.B.D.D., Supp. no 35 (1989), p. 106.
14. Voir, pour un très bon exposé de la situation dans le Marché commun, F. Capelli, "La liberté de circulation des marchandises dans la Communauté économique européenne et la loi allemande sur la pureté de la bière", *Revue du marché commun*, déc, 1987, pp. 603-702.
15. *Dans l'affaire de l'obligation du Canada en matière de débarquement du saumon et du hareng de la côte du Pacific*, Rapport final du Groupe spécial, 16 octobre 1989.
16. Sur la distinction entre intégration négative et intégration positive, voir I. Bernier, N. Roy, C. Pentland et D. Soberman, "Le concept d'union économique en droit international et en droit constitutionnel, dans M. Krasnick, ed., *Points de vue sur l'union économique canadienne*, volume 60 des études de la Commission royale sur l'union économique et sur les perspectives de développement du Canada, Approvisionnements et Services Canada, 1986.
17. Article 601 (2) de l'Accord de libre-échange.

Session II — Digest of Discussion

In the ensuing discussion, the first point to be raised dealt with the concept of consultation in relation to trade negotiations. Concern was expressed that consultation can be seen as an absolute *de minimis* measure of cooperation — for example, the opportunity to be informed of crucial matters at five minutes before midnight. However, one participant was quick to point out that in the process of the negotiation of the FTA, the federal government's perspective on the meaning of consultation had much more to do with "working together" towards achieving the ultimate federal government position that would adequately reflect all the necessary inputs. Nonetheless, the participant acknowledged the need for a greater consensus on the practical meaning of the term "consultation" in trade negotiations.

Ivan Bernier's model of positive-negative integration as it relates to constitutional interpretation elicited two questions from the floor. The first questionner wondered what powers might possibly be transferred from the provincial governments to the federal government if this model were to be applied to Uruguay Round agenda items. Focusing on the obvious example of subsidies, Bernier thought that there was significant potential for a judicial decision rendering such activity as beyond the competence of a provincial government to the extent that a province uses such subsidies for the purpose of influencing international trade. However, he feared that a broad judicial decision on a specific case might operate a full transfer of competence from the provinces to the federal government — this might not be what was intended and, indeed, might not be at all desirable.

Another participant asked Bernier if there was any indication in the current thinking of the courts that they may be disposed towards adopting a test based on the theory of shifting presumptions of positive-negative integration measures. While he did not think this was yet particularly evident, Bernier was encouraged by the gradual movement of the Canadian court towards thinking more in economic terms. He lamented that in the past, judicial decisions were based often on judgements from 50 years previous, which paid no heed to economic reality. In this sense, the American and European Community judicial systems have traditionally been set apart from Canada's in that there has always been a strong current of thinking of such problems in economic terms.

Robert Richards, in his earlier presentation, had identified two categories under which the "Trade and Commerce" power had force, the first dealing specifically with international and interprovincial trade and the second comprising the general power. Citing the example of the alcoholic beverage cases, one participant noted the increasing linkage between international and interprovincial trade barriers and wondered if the federal government might use its section 91(2) powers to deal with interprovincial trade barriers. In response, Richards asserted that this was highly unlikely given the nature of the problem and the nature of the powers being considered: that is, the Trade and Commerce power deals primarily with legislative competence, whereas most of the interprovincial trade-barrier problems have no specific legislative roots and are rather a function of the province acting as a proprietor or purchaser.

A participant queried why section 121 of the constitution has not been more effective in addressing problems relating to interprovincial trade barriers. In response, Ivan Bernier reflected on the "curious history" of section 121 in that while it had the potential for a considerable impact on such trade matters, the Supreme Court has limited its application to tariff duties, leaving all other matters to be considered under other sections of the constitution.

As in other sessions throughout the conference, attention was drawn to the significance of the current constitutional impasse over the Meech Lake Accord. As Ivan Bernier remarked, it was a rather curious phenomenon to be discussing future possibilities in the development of constitutional law and international trade policy when the ultimate resolution of the Meech Lake process has the potential to drastically affect the evolution of the entire Canadian constitution for years to come.

III

Managing Economic Relations in a Federal State

Chairman's Remarks

Gordon Robertson

I was very interested when Ivan Bernier said so rightly that the things we are talking about here really all depend on what happens about the Meech Lake agreement. It reminded me of May 1986 when Gil Rémillard unveiled the five points on the basis of which the government of Quebec, which was a reasonably new government at that time having come into power in December 1985, would be prepared to join the constitution of 1982 from which Quebec was excluded and which it felt, while the Constitution as then revised had legal application to Quebec, was not acceptable. It was a fascinating and a moving experience because for those of us who had been involved in federal-provincial negotiations over 20 years up to that time, this was by far the most modest, limited group of proposals that any government of Quebec had ever presented. I speak from personal experience as I heard the presentations and the discussions under Liberal governments, Union National governments and Péquiste governments. This was by far the most modest and most limited set of proposals and one felt that we finally had got it. We were going to solve the problem. That was May 1986. It took 11 months to get things in shape for the Meech Lake meeting on 30 April 1987 and the Meech Lake agreement came out, called by Mr. Stanfield and Mr. Pickersgill, leaders in their day on opposite sides in the House of Commons, a miracle to get the 11 governments to agree on anything, particularly on something constitutional. Then in June 1987 we had the Meech Lake Accord put into legal form as the *Constitutional Accord 1987*. For 18 months everything went well and for the last 15 months everything has gone badly and we have three months left. It really is going to be absolutely critical to the future of this country and to everything we are talking about today how the Meech Lake Accord comes out. If it is approved, I am convinced that we will have a substantial period in which we move onto other things that need to be changed in the constitution and satisfactory conditions under which the country can adapt to the requirements of trade, global challenge and all the things that we have been talking about. If the Meech Lake Accord does not go through, we are going to have a period of enormous difficulty in which the country is frozen. No changes, no adjustments will take place and a lot of the things we are talking about today will be handled and dealt with in an atmosphere of animosity and difficulty.

So all we discuss here is, as Ivan Bernier said, contingent and subject to something that is hanging over us. It may be resolved and it may not be resolved.

The Evolving Role of the Provinces in Canadian Trade Policy*

Douglas M. Brown

Introduction and Background

INTRODUCTION

To achieve results in its external trade relations Canada is faced with two sets of negotiations. The first set is with our trade partners; the second set occurs domestically. Within these domestic negotiations, those with the provincial governments have become increasingly prominent. The idea of conducting multiple, simultaneous negotiations to achieve a policy result is not surprising. After all, it is rare for a policy-maker to not have to conduct continuous bargaining, lobbying, consultation or sabre-rattling on both the domestic and external fronts, in order to make progress. This mediating role is practically a definition of what a policy-maker does.

Nevertheless, the conduct and substance of trade policy has until recently in Canada been the sole preserve of the federal government. Canada is not alone in having to face, as a federal state, an increased role by the "subnational" units of the federation in international affairs.[1] Yet, it is conventional wisdom that the domestic politics of trade relations in Canada appear to have evolved with a rather unique emphasis on intergovernmental relations between the federal and provincial governments. How have these relations evolved? To what extent are they unique? Do they present problems for effective trade relations for Canada?

The purpose of this paper is to examine the evolving role of the provinces in the making of trade policy in Canada. The first part of the paper provides background comments on how the provincial role has arisen, with emphasis on the increasing interdependence of economic policy-makers at all levels of government, and the constitutional, regional economic and institutional framework of executive federalism that characterizes intergovernmental relations in Canada. The second part reviews the evolution of the provincial role through a series of successive trade negotiations, including the ongoing Uruguay Round of Multilateral Trade Negotiations. The third part examines the role of provinces in trade dispute resolution through the two examples of the softwood lumber dispute with the United States and the liquor board dispute with the European Community (EC). The fourth part presents a brief review of the comparative experience of trade policy-making in other federal states, principally Australia, the United States and West Germany. The final part of this paper attempts to draw together conclusions from both the recent Canadian experience and the ongoing experience of other federal countries regarding more effective management of trade relations for Canada. The intent will be to sketch out the options for the future conduct of the domestic "negotiations" for making trade policy in Canada.

BACKGROUND ISSUES:
CANADIAN FEDERALISM AND INTERNATIONAL ECONOMIC RELATIONS

The federal character of Canada has always influenced its international relations. It has shaped Canada's image and personality abroad, and at least for the past 50 years, it has cast its features onto foreign policy in many areas.[2] As Canada evolved into a fully sovereign country early in this century, it did so with some unique constitutional constraints, even among federal countries. Together with recent developments in trade policy and in the Canadian federal system in general, these constraints provide the background to the evolving role of the provinces in trade policy. These developments can be divided into two sets of factors: those that are external to Canada as provided by the changing international environment for foreign policy; and, those that are internal as provided by the institutional and societal forces that have shaped Canadian federalism.

External factors:

> le rôle des provinces dans les relations extérieures reflète à la fois l'internationalisation de la politique intérieure et l'intériorisation des relations internationales...[3]

The external factors that have drawn Canadian provinces into the field of external trade policy are factors that are not unique to Canada. The chief factor is global interdependence in which formal sovereign actors have become increasingly interdependent among themselves. At the root of this interdependency is the meshing of global and domestic concerns in a more complex and interconnected world. This is not a new phenomena but it is characteristic of the second half of the twentieth century in which the concept of global village has emerged thanks to communications and transportation technology, and to social, economic and political forces that have global reach.[4]

The stuff of foreign policy has been transformed as well. In the context of relations between "nation-states," international relations has exploded far beyond the politics of war, peace and commerce to embrace the comprehensive scope of the modern welfare state. But international relations has expanded in other ways too, which tend to belie the very term. The words "transnational" and "trans-sovereign" have been coined to describe the proliferating relationships between non-sovereign or semi-sovereign actors within sovereign states, and other such actors or indeed fully sovereign actors in other sovereign states.[5] For example, there are the external relations of corporations, cities, churches, and "non-governmental organizations" of all sorts.

A special subset of these relations has been called "subnational." It is a term that applies to any governmental actor that is a constituent unit of another sovereign state, whether that be an administrative unit of a unitary state (*départements* in France) or a "federated unit" of a larger federal union (Canadian provinces, Australian states, or German *Länder*).[6]

Regardless of the terminology, the reasons for the increase in the subnational international activity are the same as for the simultaneous broadening of the scope of foreign policy: global interdependence, or more especially, economic interdependence. Never before, at least in Canadian history, has the global economy imposed itself with such force as in recent years. Virtually all sectors of the Canadian economy must compete in the face of internationalized capital and liberalizing markets in the race for comparative advantage. The pervasiveness of this economic challenge, and its threat to established communities, distributions of income, and the entire postwar welfare state, translates into pressure on political institutions. This pressure does not discriminate. It can apply to a local city council just as it does to the provincial or federal governments.

In reacting to these trends, Canadian provinces have attempted to shape some of the very same forces that so remorselessly influence the daily policy environment at home. Five roles can be defined. First, provinces act as salesmen for trade and investment in markets outside Canada. Second, they act as regulators and intervenors in their domestic economies. To the extent to which such regulation and intervention distorts the free market for trade and investment, these actions have an impact on the international economy. Third, provinces are purely commercial actors as purchasers or providers of goods and services in private-like international business transactions. Fourth, provinces engage in direct relations on economic matters through exchanges, agreements, lobbying and other means with other subnational or fully sovereign foreign governments. And fifth, provinces act as advocates and collaborators in the shaping of foreign economic policy of the federal government. This paper is most concerned with this fifth role, but the involvement of the provinces in trade policy clearly implicates the other roles as well.[7] These five provincial roles are similar to the role played by subnational governments in other federal countries, contributing to what has been called "perforated sovereignty."[8]

"Perforated sovereignty" of nation-states complicates trade policy. The scope of what constitutes trade relations and trade policy has broadened in the past 40 years. Since the adoption in 1947 of the General Agreement on Tariffs and Trade (GATT) by 23 signatories including Canada, the ambit of trade policy has expanded beyond the original emphasis on tariffs as the chief means of regulating trade, to embrace what is in its broadest terms an "economic constitution" between states. However, only since the Tokyo Round of Multilateral Trade Negotiations under the auspices of the GATT in 1973-79, have non-tariff measures been a primary focus of policy-makers.[9] Some categories of trade practices such as measures to counteract dumping and government subsidies have been around for decades. However, the recourse in recent decades to what Rodney de C. Grey has called "contingency protection" has raised these issues to prominence on the trade policy agenda. Other issues such as the extension of trading regimes beyond goods to include services, intellectual property and investment, as well as the inclusion of categories of goods largely exempt until now, such as agriculture, have also served to expand the scope of policy beyond tariffs.

The expanded definition of trade policy and relations has been, of course, in reaction to the expanded role of governments in the intervention and direct regulation of trade, which has occurred with unprecedented intensity since the Second World War. This trend has challenged and greatly complicated the often contradictory efforts through successive GATT rounds and elsewhere to liberalize world trade. In the process, trade policy-makers have had to deal with a much broader constituency than was previously the case. As noted, in almost all countries this broader constituency includes subnational governments and in Canada includes the provinces. Nonetheless, there are features unique to the Canadian version of this broader phenomenon, for reasons peculiar to constitutional and regional conditions in Canada.

Internal factors:

The federal system in Canada is neither solely the outcome of regionalized economic and social forces nor of the determinants of institutional formation.[10] When assessing the underlying reasons for an increased role of the provinces in Canadian trade policy, one is faced with an interplay of factors. Constitutional provisions and practice have carved out a role for provincial jurisdiction in many matters impinging on trade policy, especially so with the broadening of the scope of trade policy described above. Added to this is the development throughout Canadian history of significant regional differentiation in economic roles, which previous trade policy not only highlighted, but in some measure created.[11] Federal and provincial policy objectives overlap, and governments are interdependent on one another to achieve policy results. Finally, the institutional legacy of parliamentary government combined with federalism has resulted in the development of intergovernmental relations with a marked, although not unique, emphasis on relations between or among the executives of the federal and provincial governments — "executive federalism," as first coined by Donald Smiley.[12] These three factors — the constitutional framework, the regional political economy, and executive federalism — provide the internal factors to understanding the evolving role of the provinces in Canadian trade policy.

The constitutional framework need only be sketched here briefly.[13] The federal government has a wide array of constitutional powers, which confer upon it the primary responsibility with respect to external trade policy. These include the royal prerogative for treaty-making, the trade and commerce power (s.91(2)), customs and excise (s.122), monetary matters (s.91(14-21)), national transportation systems (s.91(10)c), the declaratory power (s. 92(10)c), certain provisions for an economic union (s.121) and the peace, order and good government interpretive clause (s. 91 preamble).[14] The major impediments to federal jurisdiction have been the split jurisdiction for the implementation of treaties, and the limited reading of the trade and commerce power.

Canada's constitutional practice stipulates that while the federal government has full powers to enter into treaties, it cannot implement them where the subject matter falls within provincial jurisdiction. This practice has been determined by judicial review, in particular the landmark judgement of Lord Atkin of the United Kingdom's Judicial Committee of the Privy Council (JCPC) on the *Labour Conventions* case on appeal from the Supreme Court of Canada in 1937. Thus Canada as an international personality has been able to meet international obligations in the broad areas of provincial jurisdiction only where a provincial consensus to proceed has existed. Villified at the time by legal scholars and others who saw the JCPC as preventing a strong central response to the crisis of depression, this judgement and others of its time have nonetheless preserved a notion of federal balance that is in marked contrast to the constitutional law and practice in other federal states, which is discussed later in this paper.[15]

Jurisprudence over the trade and commerce power has not been so cut and dried as it has been for treaty implementation.[16] The power has been curtailed in significant ways when compared with the prevailing commerce power in the United States and Australia. Intra-provincial trade has been virtually exempt from federal jurisdiction, and even interprovincial and international trade has not been so broadly defined as to prevent a large measure of resource management and industrial policy resting with the provinces. However, recent jurisprudence suggests a strengthening of the trade and commerce power under certain conditions such as where a national regulatory regime is contemplated. This new interpretation may already be having an effect on the federal government's perceived if not actual constitutional resources. A discussion of this issue in relation to the Canada-United States Free Trade Agreement may be found later in this paper.

On the provincial side, the constitutional powers of property and civil rights s.92(13) and s.92 (16), "all matters of a merely local or private Nature in the Province,"[17] have been interpreted widely to give the provinces considerable leeway in matters related to trade. When combined with provisions for the management and ownership of natural resources, the provinces are left with great latitude to manage economic development in their territory. In relation to the agenda of current trade policy, provincial jurisdiction has allowed the exercise of a number of practices that now come under the rubric of "nontariff barrier" in trade policy parlance. John Quinn has identified the following six categories into which a broad range of provincial measures may fall: (a) purchasing policies by provincial governments and their agents; (b) the regulation of services within provincial boundaries; (c) agricultural policies, in particular the supply management apparatus, but also other support programs and standards; (d) resource management policies that control exploitation, export and transformation of natural resources; (e) industrial policies including subsidies; and (f) regulation of the sale of alcoholic beverages.[18]

When considering the constitutional resources that the federal and provincial governments bring into play, two cautionary notes are worth making. First, the jurisprudence surrounding the ongoing interpretation of constitutional law is in constant flux, and while a strong propensity towards federal balance seems to have prevailed over time,[19] one cannot rule out future interpretation, which could tilt the balance in favour of the federal government in the face of the prevailing anxiety about the global economic challenge. Second, the existence of constitutional resources does not always ensure their use. It takes political will to flex legal muscles, and it is not only in Canada where the federal government has at times stepped back from pushing its perceived jurisdiction to the limit. To better understand these political constraints, it is important to review the regional economic background to trade policy in Canada.

The regionalized economy of Canada has been a major factor in the domestic consideration of Canada's trade policy throughout most of our history. Canada, as an economic unit, was created in 1867 partly in response to the abrogation of the Reciprocity Treaty with the United States. Free trade or protection was a constant political theme throughout the nineteenth century. With the inauguration of a more comprehensive national tariff structure in 1879 (the "National Policy" as it would later be called), the stage was set for the integration of an east-west economy behind relatively high tariff walls. The putative effects of the National Policy in determining the regional division of labour within Canada were not necessarily evident in the nineteenth century. Manufacturing only slowly declined in the Maritimes. The west was too busy coping with the settlement boom to notice. Only in the 1920s and onward has the national tariff become an essentially regional issue. (It had always been a sectoral issue, as the farming community across Canada was in favour of free trade at least until the end of World War II.)[20]

With the eventual concentration of manufacturing in Ontario and Quebec, especially after 1921, the primary economic activity in the western and Atlantic provinces has been in the export-oriented resource sectors. The regional alienation fueled by growing disparities in wealth, population, economic growth and diversity, has often focused on the perceived disproportionate benefits and costs of Canada's essentially protectionist trade policy. This policy has been blamed for raising consumer and industrial costs in the resource-producing regions, keeping the Canadian dollar higher than it should be, to the detriment of exporters, and preventing the diversification of western and Atlantic industry based on export markets. Economic analyses support the political perspective of the outlying regions that the National Policy has had negative effects on their economies as well as on the country as a whole.[21]

The progressive liberalization of Canada's tariff structure through successive GATT Rounds since 1947 has considerably lessened the overall impact of protection in Canada, but not the political desire in certain regions for more liberalization. Canada as a whole has become more, not less, trade dependent. This has been especially so in the resource-producing provinces. With the rise through the 1970s and 1980s of "neo-protectionism" in Canada's trading partners, so too has arisen an intensified regional debate about Canada's use of these same "neo-protectionist measures" and the constraints imposed by them on the export interests of the resource-producing provinces.[22]

The notion of an immutable regional division of labour with respect to the interests of specific regional economies is untenable. Regional interests do change, if slowly and subtly. Perhaps the most important change in the past 20 years in Canada has been the general trend of the manufacturing sector to look outwards to export markets, and on a regional basis, the position of business and other interests in Quebec. In the 1970s the Canadian Manufacturers Association was still quite protectionist, and in Quebec in particular, trade protection was still considered important, due to the prominent "soft sectors" of textiles, clothing, furniture and footwear. This position has given way to a more open position and a willingness to make the adjustments necessary for greater liberalization.

This is not to say that regional tensions do not now exist or will not recur. As will be discussed [illegible], the Uruguay Round may expose regional tensions over trade policy even more so than has debate over the Canada-U.S. Free Trade Agreement. However, the constellation of regional interests and the nature of conflict will vary considerably from one set of negotiations or trade dispute, to another, and there is to some degree less rigidity in regional interests on trade policy than was formerly the case.

Regional variations of interests are of course common in large countries. In Canada, however, the expression of regional interests has come to be concentrated in provincial governments.[23] This concentration arises in part from the legal jurisdiction, provided to provincial governments by the *Constitution Act, 1867* and subsequent judicial review. Added to this is the fact that federal government institutions have not functioned to provide an acceptable degree of representation of regional interests.[24] Party discipline in Parliament, and the declining legitimacy of an appointed Senate have reduced the ability of members of Parliament to speak out on regional matters. So too, the effect of modern media, especially television, to relay directly the representational role to constituents, has reduced the effectiveness of the quiet broker role of regional ministers in the federal cabinet, and conversely increased the role of provincial premiers, who have no similar constraints on speaking out for the interests of their province.

As a result of these developments, the pattern of intergovernmental relations, already disposed to emphasize executive relations, and burdened with the task of dealing with the overlapping jurisdiction and interdependencies of the modern exercise of government, comes to carry the function of regional representation as well. This phenomenon of provincial representatives pronouncing regional views on matters within national jurisdiction has created considerable debate, especially since the mid-1970s. It can work both ways. In the interdependent policy environment today, federal representatives are equally adept at pronouncing on matters in provincial jurisdiction. Thus it is the interdependence of governments, and a focus on intergovernmental relations which is of relevance.[25]

This regional representation role of the provinces is an important underlying factor in the domestic politics of Canadian trade policy. Almost by definition, trade policy generates regional conflicts, as discussed above. The provincial role as chief advocates for regional interests when combined with the constitutional authority of provinces in so many matters in trade policy, creates the conditions for federal-provincial relations in trade policy. The one factor feeds on the other, lending political legitimacy where legal force alone may not suffice. The case need not be overstated. The federal government has much jurisdictional clout in trade matters. It also has significant ability to represent or reflect regional variations of interest. However, the combination of factors here described, when combined with the evolution of executive intergovernmental relations so well entrenched in recent decades, has meant that the federal-provincial dimension has become increasingly more complex and more prominent.

In order to demonstrate the nature of this development, the following sections explore the nature of federal-provincial relations regarding a series of trade negotiations and through two important trade disputes.

Provincial Involvement in Trade Negotiations

The developments described in the first part of this paper have led to an increasing role for provincial governments in trade-policy formation. How has this role evolved in practice? What are its structural strengths and weaknesses? What lessons can be drawn from this experience? In an attempt to answer these questions, the next two parts of this paper examine recent experience with respect to trade negotiations and trade disputes.

Trade negotiations are treated separately from individual disputes because full-scale negotiations are more wide-ranging and they have the potential to involve all provinces. Especially in the early stages of any negotiation when the agenda tends to be as broad and open as possible, expectations about results and worries about consequences are also broad. As Gil Winham so rightly points out, the early stages of negotiations are fraught with difficulty as the players jockey for position, but they can also be the most "creative" period in the entire negotiation.[26]

The following discussion traces the provincial role through four phases: relations in general prior to 1973 when the Tokyo Round of Multilateral Trade Negotiations began; the Tokyo Round years, 1973 to 1979; the bilateral negotiations leading to the Canada-United States Free Trade Agreement; and the current process of provincial involvement in the Uruguay Round.

THE PROVINCES AND TRADE POLICY BEFORE 1973

Until 1973 the provinces were simply not involved in any systematic way in the making of Canadian trade policy.[27] Provincial leaders spoke out on sensitive matters of trade, or through quieter channels, made their views known. Nonetheless, through the various tariff cutting rounds under the auspices of the GATT, up to and including the Kennedy Round in the late 1960s, no formal mechanisms for the receipt of provincial views on trade matters appears to have existed. Even for such a momentous bilateral agreement as the Canada-United States Autopact, the provincial government of Ontario was simply not involved.[28] Contrasting this situation with the debate between Premier Peterson of Ontario and Canada's trade negotiator Simon Reisman during the recent bilateral negotiations about whether or not the autopact was on the table is merely to underscore how the perceived provincial role in articulating their interests in matters of federal jurisdiction has changed in a matter of only 20 years.

As a signatory to the GATT since 1947, Canada has been bound by the "federal state clause." This provision, Article XXIV (12) states:

> Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory.[29]

The requirement to take these "reasonable measures" appears to be mainly a "best efforts" provision, which is not legally binding on the provinces.[30] As will be discussed below in relation to the liquor boards dispute, there is the perception that Article XXIV (12) has been used by Canada's federal government and others as an excuse for not delivering on perceived obligations. Other GATT parties have sought to interpret the meaning of "reasonable measures" as requiring the federal government to use all available constitutional power to obtain provincial compliance, while Canada and other federal countries have argued for the inclusion of such "federal" clauses to prevent international agreements from compromising their internal federal structures. Nonetheless, there does not appear to have been any case, prior to the Tokyo Round, where provincial compliance in Canada was an issue. This is due to the fact that tariffs, quantitative restrictions and other measures, which were on the agenda fell within exclusive federal jurisdiction.

To conclude, the provinces were involved, if at all, only sporatically, in the formation of Canadian trade policy until 1973. Part of the reason for this was the narrow scope of trade negotiations. Also the aggressive provincial articulation of regional interests in matters of trade policy did not reach its stride until the 1970s. This left the provinces in the same role as other constituent interested parties. As Gil Winham quotes a federal source, the provinces "got told when everyone else got told,"[31] of the results of the successive GATT Rounds up to 1973.

THE TOKYO ROUND OF MULTILATERAL TRADE NEGOTIATIONS

The tariff cutting rounds of multilateral trade negotations preceding the Tokyo Round had reduced the tariff in most industrial countries to the extent that the nontariff barriers became more visible, and indeed were used with more frequency in the absence of tariff-led protection.[32] Thus when the Tokyo Declaration kicked off the next round of trade talks in 1973, nontariff measures where prominent in the negotiation agenda, as were formula-based tariff negotiations, and sectoral negotiations on agriculture and fisheries, resource products and tropical products. Among the categories of nontariff barriers that eventually found expression in Tokyo Round codes were subsidies and countervail, government procurement and technical barriers. All of these had at least the potential to affect provincial jurisdiction and were of keen interest to several provincial governments.

It would appear from the record of events [33] that the provincial role in these negotiations changed considerably through the course of the six-year period. The actual negotiations proceeded slowly, and only with time did it become clear how important nontariff barriers were to the total result. Canada's stakes in gaining improved market access and in improving the legitimacy of the system depended upon its agreement to new disciplines on the nontariff measures.

At first the only mechanism for formal provincial input was the Canadian Trade and Tariffs Committee (CTTC), chaired by a federal deputy-minister. The CTTC received and coordinated briefs from all interested parties, including firms, industry associations, unions, consumer groups and provinces. By 1975, an ad hoc federal-provincial committee of deputy ministers was created to discuss the MTN agenda; it was said to be "both more political and more continuous" a forum for federal-provincial consultation than the CTTC.[34] Finally, in August 1977, the federal government appointed a Canadian Coordinator for Trade Negotiations (CCTN) with a broad mandate to coordinate input across departments in Ottawa, from industry and from the provinces. This input was fed directly to the federal cabinet and to the Canadian negotiating team in Geneva. Jake Warren, then Canadian Ambassador to the United States, took on the job, which included chairing the federal-provincial committee. According to Gil Winham, Warren's position helped to focus provincial bureaucratic input to the negotiations. The provinces saw this as an improvement over the CCTC which was not perceived as having any determining influence over the Canadian negotiating position.[35]

Some provinces clearly wanted more direct involvement. Among others, the governments of Ontario, Quebec, British Columbia and Alberta sent representatives to the negotiations in Geneva, although Ottawa did not agree to their formal inclusion in the Canadian delegation. Quebec even had a permanent representative domiciled in Geneva for the negotiations. Nonetheless, throughout the round, especially in its later stages, all the provinces were kept informed of the progress of the negotiations, and virtually all the provinces provided detailed positions to the federal negotiators. Thus began a movement along the learning curve for growing provincial expertise in trade matters, as more professional and other resources were devoted to the analysis of trade issues and detailed consultation with local economic actors in each province. (During this period the provincial bureaucracies in general were now able to rival the federal government in sophistication and professional standards.)[36] This provincial input helped to sustain the federal negotiating strategy in areas of provincial policy such as procurement and liquor board practices, and for some sectoral concerns, provincial analysis provided an important supplement to federal information.

This overview of the structure of the federal-provincial process gives little indication of the underlying interests of the provinces in terms of substantive agenda items. This is beyond the scope of this paper, but it is worth recalling that throughout the 1970s, the federal government conducted a long and protracted debate with the provinces over industrial policy and regional economic objectives. There were first ministers' and many ministerial meetings on these themes. Trade policy figured prominently in the vocal concerns of the western provinces, especially at and after the Western Economic Opportunities Conference of 1973. Also of note, the Parti Québécois government after 1976 was anxious that the Canadian position of the MTNs not unduly jeopardize the Quebec Government's objectives for an autonomous economic development policy. In sum, this was not a period in Canadian intergovernmental relations when the provinces were content to leave Ottawa to proceed unfettered in national economic policy, regardless of the details and sensitivities of maintaining a negotiating position in Geneva.[37]

In terms of substantive results, the Tokyo Round did directly affect provincial jurisdiction. The most prominent of the Canadian commitments that implicated the provinces was the 1979 Statement of Intent on liquor board practices, discussed more fully below. Other commitments were embodied in the various nontariff barrier codes. The code on civil aviation, the code on technical barriers, and the code on subsidies and countervail all include "federal state clauses" by which Canada is committed to making at least its best efforts to ensure provincial compliance.[38] The code on government procurement, however, excluded provincial governments or their agents from the lists of Canadian entities covered.

In the end, the provinces were not affected by the results of the round to the degree that had been expected through the negotiation process. This is not to say that the latitude that the federal government may have had to commit the provinces was constrained. By having the provinces on side through extensive consultation, the federal government was able to play with a more complete deck, even if certain cards were not used in the final round. The general opinion of the federal-provincial consultation process in the Tokyo Round, especially after the establishment of the coordinator's office, was that it contributed to an effective Canadian position. For example, the final report of the Macdonald Commission recommended the use of the "successful" procedure followed during the Tokyo Round in future trade negotiations, in particular for the bilateral trade negotiations with the United States.[39]

CANADA-UNITED STATES BILATERAL TRADE NEGOTIATIONS, 1985-87

The bilateral trade negotiations with the United States stand apart from the previous MTNs for several reasons. The objectives outlined by the federal government for the negotiations were much more comprehensive than those for any previous Canadian trade negotiations. The political and economic stakes were much higher, and therefore the public profile of every aspect of the negotiations, including the federal-provincial process, was much higher as well. Indeed it can be argued that throughout the bilateral trade negotiations (BTNs), and until the Canada-United States Free Trade Agreement (FTA) was signed on 2 January 1988, the federal-provincial dimension dominated domestic debate in Canada. Only after the signing of the FTA, did the debate in Parliament over the implementing legislation overshadow the intergovernmental arena.

This is not to argue that the intergovernmental discussions within Canada were the only form of domestic negotiation involved in the bilateral trade negotiations. The federal government also instituted in the period of 1985-88 what appears to have been a highly successful (if much less high profile) set of consultations with the private sector. These consultations were formalized in the establishment of an International Trade Advisory Committee (ITAC), chaired by Northern Telecom chairman Walter Light, and by 15 Sector Advisory Groups on International Trade (SAGITs). Much detailed advice from the private sector reached the federal government through these groups, and in turn private sector representatives were kept informed of the Canadian position. Several provinces also had their own industry consultative mechanisms, some more formal than others, and kept in touch with the federal ITAC and SAGITs. Further analysis of this whole area of relations is beyond the scope of this paper, but it bears keeping in mind that Canadian trade negotiators were faced with the requirement for consultation and participation in trade policy from a broader front than just the provincial governments.

Nonetheless, from the beginning of these negotiations, it was generally accepted that many of the substantive items on the long agenda would include matters in provincial jurisdiction. Provincial subsidies, government procurement, liquor board practices, agricultural marketing boards and regulation of services and investment were only the most prominent of the potential issues to be covered.

The federal-provincial consultation that resulted reveals a lot about the strengths and weaknesses of the consultative process, and about the limitations of intergovernmental relations — for both sides — in achieving trade policy results. This process can be described through three distinct phases: the initial phase of jockeying for position; the middle phase of smoothly running federal-provincial relations, and the final phase of brinkmanship negotiations when the federal-provincial consultation process was disrupted in the final push to get an agreement.[40]

The issue of the exact nature of provincial participation in the BTNs had been brewing for some months when it landed at the Annual First Ministers' Conference in Halifax, 28-29 November 1985. There the first ministers managed to agree on the "principle of full provincial participation" in the BTNs, but it took until June 1986 before the meaning of that phrase became clear. The most hawkish provinces, led it would seem by Ontario and Alberta, were proposing a provincial role that would be substantially enhanced from that of the Tokyo Round. This would be in keeping with the new era of "national reconciliation" ushered in by the election of the federal Conservatives in 1984, and by the unprecedented scope of the proposed BTN agenda. In March 1986, Premier Getty proposed to Prime Minister Mulroney, on behalf of the provinces, a set of modalities for participation that included, among other things: the establishment by all first ministers of a joint mandate and joint control over Canada's chief negotiator; full provincial representation on the Canadian negotiating team, including the option of being "in the room" with the Americans; full participation in the negotiating strategy; and full information sharing in confidence with the federal negotiators.[41] At this point the federal government had already appointed chief negotiator Simon Reisman, and was in the process of establishing Riesman's mandate, and staffing a special Trade Negotiations Office in Ottawa. In any case, the federal government was not prepared to go as far as Getty had proposed. Perhaps in the knowledge that not all provinces would insist on such fullsome participation, Prime Minister Mulroney received the premiers' acquiescence in June 1986 to a process that included the following details:

1. The first ministers would meet once every three months for the duration of the negotiations, to review their progress. The first such meeting was set for 17 September 1986.
2. Designated ministers would meet as required, chaired by the new federal Minister for International Trade, Pat Carney.
3. There would be only one Chief Negotiator for Canada, Simon Reisman, who would be fully responsible to the federal cabinet for the conduct of the negotiations. The Trade Negotiations Office (TNO) would be

completely under the Chief Negotiator's supervision. There would be no provincial representatives in the TNO or in negotiating sessions with the United States.

4. The Chief Negotiator's mandate would be established by the federal government, in consultation with the first ministers and the designated ministers.
5. There would be close ongoing consultation through the CCTN with Simon Reisman as Chairman. The CCTN, which had met once a month since January 1986, would continue to meet as often as required. Its function would be to provide liaison and advice.
6. The federal government would formally seek the views of all provinces prior to endorsing any agreement. There was no agreement on the issue of the role of provinces in the ratification or implementation of the agreement.

As a result, the federal government achieved the control it felt was essential over the chief negotiator and his team. The provinces obtained their minimal requirements for consultation. Provincial representatives would not be in the room, but they would have an important input to the Canadian strategy and the conduct of the negotiations.

The second phase of the consultative process, lasting until September 1987, consisted of intense and varied intergovernmental relations over the ongoing substance of the negotiations. The key forum was the monthly meeting of the CCTN, supplemented by meetings of federal-provincial subcommittees on a few key issues involving provincial interests. In addition to these technical consultations, there were the odd ministerial briefings, and the quarterly first ministers' meetings, often over dinner. There were, as well, inumerable bilateral meetings of officials, phone calls and correspondence. The key features of this stage of consultation were that, for the most part, a degree of professional trust prevailed, and information was shared in confidence. The provinces were kept informed and had an input into the substance of the Canadian negotiating position. The degree of information and input appeared to exceed that of most other domestic actors, including the private sector, other federal departments and Parliament. Only the TNO itself, the Prime Minister's Office and the special subcommittee of the federal cabinet on trade appeared to have greater access to the negotiating process.[42]

Nonetheless there were problems with this federal-provincial process on both sides. Provincial representatives sometimes felt that the TNO was attempting to stifle debate through lengthy presentations, or that they were not forthcoming on a number of issues. The federal officials could complain about the occasional leaks of information, and that some provinces were not being sufficiently forthcoming about their positions on sensitive matters. These problems do not detract from the general conclusion that the process of consultation, including officials and politicians, worked extremely well within the limitations of what consultation means. Without a full discussion and debate at each stage and on every major issue over the eighteen-month period preceding the final agreement, the provinces could not have been on side on the many technical issues involved in the negotiations. Without this support, Canada could not have gone forward to the Americans with an integrated Canadian position.

The last phase in the process was precipitated by Canada's halt in the negotiations, and by the last-minute rescue effort at the end of September and right up to the 3 October deadline that had been imposed by the U.S. Congress. In this last push the provinces were not consulted in any formal way, so that the 31-page *Elements of the Agreement* contained features that could not have been completely foreseen by the provinces. Chief among these was the lack of agreement on trade remedy process, except within the context (as important as it was) of a new binding dispute settlement mechanism.

Most other features of the Agreement were not a surprise. The provisions with respect to the Auto Pact, cultural programs, investment and energy were, in their basics, known to the provinces as a likely outcome well before the final push. Nonetheless, it may have been the case that the full import of the proposed measures was not appreciated by the provincial representatives, let alone debated with the federal negotiators.

Throughout the period from the release of the preliminary agreement to the release of the detailed legal text, there were again no formal meetings with the provinces, although several bilateral meetings took place as a result of which not a few minor compromises and concessions were made.[43]

The foregoing sketches out the basic features of the federal-provincial process during the BTNs. It would be a less than complete picture if some of the prevailing political debate was not also included. The federal-provincial process became increasingly untenable under the pressure of high profile opposition to the Canadian negotiating position from Ontario and Manitoba. In particular Premier David Peterson of Ontario continued to raise in public fundamental doubts about the direction of the talks, especially during an election campaign that ended in a majority victory for his party on 10 September 1987. The position of these two provinces challenged the federal government to proceed without a full provincial consensus, but at the same time heightened the political leverage of the other eight provinces as sustaining supporters of the Agreement. At the end of the day, a total of eight provinces still supported the Agreement. (Although Prince Edward Island came out against it in October 1987, and an election in Manitoba on 26 April 1988 brought a more sympathetic government to power there.)

The issue of how many provinces supported the Agreement at this stage may seem to many to have been moot. For the result of the negotiations was a free trade agreement, which was surprising in how little it impinged on provincial jurisdiction when compared with the agenda during the long negotiations. The exact extent of provincial jurisdiction affected is the matter of some legal debate.[44] How and whether the Agreement was to be implemented within provincial jurisdiction has also been an issue. Article 103 of the FTA stipulates that:

> The parties to this agreement shall ensure that all necessary measures are taken in order to give effect to its provisions, except as otherwise provided in this Agreement, by state, provincial and local governments.

This is the strongest "federal state" clause to which Canada has ever agreed in a trade agreement, and has at least in potential much more clout than the comparable Article XXIV(12) in the GATT.[45] Within the main text of the FTA, provinces are mainly affected by Chapters 5 on national treatment, 7 on agriculture, 8 on wines and spirits, 9 on energy, 12 on exceptions, 14 on services and 16 on investment. However, the last two chapters noted affect the provinces only prospectively, and discounting for the moment provisions that require future negotiation (agricultural standards, subsidies, etc.), there was very little left in terms of direct and immediate impingement on provincial jurisdiction, saving Chapter 8. This begs the question about whether the federal government would have to resort to Article 103.

There was nonetheless some anxiety in provincial capitals about the nature of the federal FTA implementation legislation, and the extent to which certain provinces might be forced to challenge a bill that intruded directly on provincial jurisdiction. Despite advice from some quarters to impose the FTA with the full force of the law on the provinces, the federal government took a less intrusive route in Bill C-130 (as passed, *An Act to Implement the Free Trade Agreement Between Canada and the United States of America*). The bill included what amounted to legislated warnings about federal jurisdiction, and provisions for implementing the Agreement in the failure of provincial measures to comply, including a specific reference to chapter 8 on wine and spirits.[46]

Despite the rather non-intrusive nature of Bill C-130, the provinces of Ontario, Alberta, Quebec and Nova Scotia felt duty-bound to register a protest. Although no province went so far as to pass its own implementing legislation, Alberta did table a bill, and the Government of Quebec issued a "decree" proclaiming the implementation of the FTA within its jurisdiction.[47] Ontario passed four pieces of legislation [48]designed, it would appear, to demonstrate that FTA or no FTA, Ontario would legislate in its own interests. These were not perceived as posing a significant challenge to the federal bill, however, and were more of a blister to cure other worries for the federal government. The Government of Ontario essentially removed any further threat that it would not abide by the terms of the FTA when it settled with the federal government on the wines issue in March 1989.[49]

The federal government was therefore able to achieve the implementation of the FTA without formal recourse to Article 103 of the FTA or its legislated instruments in the FTA implementation bill. No province has yet challenged the federal legislation in the courts. All of this has occurred without any formal decision rules or mechanism to "ratify" the Agreement by the provinces. In some circles this achievement is likened to a "revolution" in favour of federal jurisdiction. This claim seems to be premised in part on the view that by not challenging the federal legislation the provinces are acquiescing in the broader prospective intrusion of their domain by the FTA. It is also premised on the assumption that a court challenge would find the entire substance of the FTA as lying within federal jurisdiction under the Trade and Commerce power. Whatever the case, it must surely be a very quiet revolution, which will only stand the test of time if it is upheld by the courts. It has certainly not diminished the provinces appetite for involvement in trade policy.

However, revolution or not, in the face of widespread public skepticism about the merits of the FTA in late 1987, the Mulroney government needed allies and got them in the support of seven provinces. This in itself should be justification for the effort exerted in involving the provinces throughout the negotiations. The consultations with the provinces were not, however, achievements in decision-making. Apart from a broad political consensus from a majority of the provinces, there were no formal means used to commit the provinces to specific provisions. The limitations in this process merit further review.

THE URUGUAY ROUND

Before concluding this part of the paper, it is useful to briefly review the prospects for the continuing involvement of the provinces in the Uruguay Round of Multilateral Trade Negotiations. A few comments on the MTN agenda, the potential difficulties for "domestic negotiation" in Canada and the federal-provincial process will suffice to illustrate that the sets of stimuli and responses in train since the late 1970s have not diminished.[50]

This round of MTNs, launched in Uruguay in September 1986 and scheduled for completion by December 1990, is easily the most ambitious round yet undertaken by the GATT parties. The negotiating agenda is unprecedented in its scope. Apart from difficult market-access issues in goods, the round is attempting to tackle the enormous problems in agriculture by devising a GATT based set of rules for agricultural trade, and rolling back the ruinous subsidies that have so distorted the world market. For the first time GATT is attempting to negotiate agreements on services, investment and intellectual property. Other agenda items are to improve the rules concerning subsidy countervail and safeguards, and the dispute settlement mechanism. Of these, six issues are likely to produce the most heat in terms of Canadian domestic politics, including federal-provincial relations. These are agriculture, market access, textiles and clothing, subsidies, government procurement and the new issues of services and investment.[51]

Like the BTNs with the United States, the agenda is comprehensive and breaks new ground. Unlike the BTNs, Canada has much less control over the total results and is unlikely to be able even to contemplate not being there at the end of the day. In terms of domestic interests, the MTNs as a strategic objective are uncontroversial, but in the details of the negotiating items are several issues that may serve to revive more traditional regionalized debates about trade policy.

Of all the provinces, Saskatchewan has perhaps the most immediate interests in the results, given the disastrous effects of the international subsidy war on its grain economy. Otherwise, the MTN agenda will be important to a number of provinces in terms of determining the parameters of many unfinished items of business with the U.S., chief of which are any changes to the GATT subsidies code.

The two issues of agriculture and textiles and clothing have the potential to raise severe regional conflicts. On agriculture, progress in general liberalization affecting export interests (concentrated in the western grain producing provinces) may conflict with the interests of the import-sensitive supply-managed sectors (poultry, eggs and dairy concentrated elsewhere). Canada has put off dealing with a GATT panel report that censured Canada's extension of its import quota system to processed dairy products, pending the outcome of the round, and will face pressure to amend its trade regime in this area. Textiles and clothing are also the subject of domestic debate and the future of import protection in these sectors (concentrated in central Canada) may be a good test of Canada's will for liberalization. Finally, government procurement is an area where, without the participation of the provinces, Canada's bargaining room will be constrained to the detriment of export interests.

The issues regarding provincial jurisdiction and implementation, while premature at this stage, are likely to be the same in potential as they were for the BTNs. An examination of the agenda reveals quite a number of provincial measures that could be affected. These include: resource pricing, resource taxation designed to favour local processing, resource export controls, government procurement, agricultural support programs, agricultural marketing board legislation, agricultural standards, industrial and regional subsidy practices, investment performance requirements such as local content rules, preferential purchases on mega-projects, local equity requirements and product mandating, and finally, a diverse range of service-sector regulation affecting among other things, establishment, investment, and the mobility of labour. Compliance by the provinces may also be a very sensitive matter for other contracting parties, in view of the unfortunate history of the liquor boards case. (This issue is dealt with in the next part of this paper.)

This leads to a discussion of the role of the provinces thus far in the negotiations. The consultative mechanisms established by the federal government for the Uruguay Round have been similar to those created for the BTNs. Indeed, through 1986 and 1987, the CCTN set up to handle federal-provincial relations on the FTA included briefings and discussion of MTN issues in its agenda. By March 1990, the federal Minister of International Trade, John Crosbie, met with his provincial counterparts on at least four occasions, and senior officials are meeting about once a month in the Committee on Multilateral Trade Negotiations. Subcommittees also meet on specific MTN agenda items. Some provincial ministers and their delegations were invited to the launch of the Uruguay Round in 1986, and all provinces were invited to the mid-term meeting in Montreal in December 1988. Provincial ministers and officials have also attended meetings of related trade fora, such as the Cairns group, with the approval of the Canadian delegation. Most provinces have sent missions to Geneva where they have been assisted by the Canadian delegation in making the rounds of other delegations and gaining first-hand information about negotiating issues. This is not to say that the provinces, any more than they were in the BTNs, are full members to the Canadian delegation, or are present in actual negotiating sessions with contracting parties.

Within the provincial capitals, it would appear that the expertise built up through the BTNs has only been slightly dissipated and provincial bureaucracies are providing technical support and advocacy for regional positions that will undoubtedly have an effect on the Canadian position. The impact of the provincial technical advice and advocacy is difficult to assess at this stage. If all of the provincial interventions are of the general quality of the recent report to the Western Premiers' Conference, *Western Trade Objectives*,[52] however, provincial positions will be influential.

As for "getting to yes," the problems of achieving binding commitments on concessions to Canada's Uruguay Round partners in areas where provincial consent is required have not yet been systematically solved, to no one's surprise. We shall return to this issue in the concluding part of this paper.

Dealing with Trade Disputes

Much of trade policy is about settling differences. Many, though not all differences are settled by a recourse to rules that emerge from negotiations or from the accumulation of precedents on the settlement of disputes about the rules. Trade disputes are the proof of the pudding. The settlement of disputes to the satisfaction of the parties to a trade agreement ensures the stability of any trade regime. In the case of Canada, a middle power that must rely heavily on the rule of law in its trading relationships, an effective and fair dispute settlement procedure in trade policy is not only just half the battle, it is an important end in itself.

No less than for trade negotiations, there is a considerable play of domestic politics in any trade dispute and in attempts to reach a settlement. Indeed, the pressure politics of a trade dispute can be considerably more focused than policy-oriented negotiations. Where trade disputes impinge directly on provincial interests or draw one or more provinces as parties into the dispute, relations with the provinces can be critical to the successful resolution of a dispute. The history of such relationships has been ad hoc and episodic, even more so than the detailed trade negotiations described above. The difficulty in maintaining a common position and the lack of means of reaching binding decisions in the domestic side of the equation in Canada has raised questions about Canada's ability to conduct effective trade relations. In order to illustrate this issue, two recent trade disputes that involved the provinces integrally are examined here: first, the softwood lumber dispute with the United States, and, second, the liquor boards dispute with the European Community.

SOFTWOOD LUMBER

In this case Canadian exports of softwood lumber ran afoul of the United States trade remedy process for countervailing subsidies. The details of the dispute are beyond the scope of this paper. However, it is important to recall a few salient points. American lumber producers had been losing U.S. domestic market share to Canadian producers since at least 1977 when, in 1982, they launched a countervail suit alleging subsidies in the Canadian production of lumber. While many federal and provincial government programs were cited in the suit, the most important point of contention was the stumpage regime in the major exporting provinces, British Columbia, Alberta, Ontario and Quebec. The suit was lost by the U.S. producers in 1983, but taken up again in 1986, under circumstances in the United States that greatly enhanced the political leverage of the U.S. lumber interests. These factors included the heightened concern over the trade deficit in the U.S., a consequentially protectionist-oriented Congress (with special vulnerability on regionally concentrated interests feeling import pressures such as the lumber sector), political pressures on the U.S. trade remedy process including proposed legislation to change the definition of subsidy with respect to trade in natural resources, and the leverage of Congress on the U.S. Administration and Canada in the start-up on bilateral negotiations towards a free trade agreement.[53]

There is no question that the central issue was provincial stumpage practice, with a particular focus on British Columbia where the biggest threat to U.S.

producers arose. For Americans, the objective was to expose Canadian stumpage practice as a subsidy injurious to U.S. producers. For Canadians, the objective was to demonstrate that not only were Canadian stumpage practices not a subsidy under generally understood definitions of the concept, but that U.S. attempts to redefine subsidy as any market condition dissimilar to their own constituted a protectionist device to deny the comparative advantage of imported goods. For Canada, however, there was also the broader issue of provincial control over crown resources, and thus an issue of perceived sovereignty. Unfortunately for Canadian lumber producers, there was ultimately no option but to abide by the rules imposed on the only market available.

The domestic negotiations in the first phase of the dispute, 1982-83, were relatively simple. Once the suit was launched, the Canadian government consulted broadly with the provinces and the industry. In the end, however, governments stood aside to allow a coalition of Canadian producers to fight what appeared to be a straight-forward legal battle on the merits of the countervail case.[54] There seems to be some confusion about whether the industry in Canada got involved because "governments were either unwilling or incapable of doing so," or whether the governments thought that leaving the legal field to the industry was the best way to avoid raising political hackles in Washington.[55] Scott Fairley has concluded that the "happy conclusion" for Canada of this phase of the dispute (a final negative determination of subsidy was reached by the U.S. Department of Commerce in May 1983), came despite the lack of a coordinated response by the federal and provincial governments. This conclusion is not supported by other commentators.[56] As long as the trade dispute could be handled through the legal route of the U.S. trade remedy process with an acceptable outcome for Canada, intergovernmental relations in Canada did not seem to pose a problem.

The second phase of the case posed a much greater threat to Canadian interests, and made a settlement more difficult. As noted above, the renewed countervail case was pursued in the U.S. under a cloud of protectionist threats. With the preliminary determination of injury from subsidized Canadian lumber announced by the United States International Trade Commission on 26 June 1986, Canada was faced with several difficult issues. If not settled to some degree of U.S. satisfaction, the dispute could derail the BTNs. If the countervail suit was allowed to take its full legal course, it could set a dangerous precedent for other Canadian resource exports (where resource input subsidies were arguably even more open to attack). Finally, an unsuccessful outcome from the existing countervail process would only precipitate new U.S. legislation with a more protectionist definition of subsidy. These issues would have a differential impact in Canada, with British Columbia having perhaps the greatest interest in seeing the dispute settled regardless of the broader consequences, and other provinces more inclined to pursue a course which either infringed less on their sovereignty or reduced the threat to other resource export interests. The federal government would have to pursue the national interest, which was at the very least defined as brokering the competing regional interests.

The strategic issue for Canada, from June through to the end of 1986, was whether or not to seek a negotiated settlement of the dispute. There were two options: the first a suspension agreement between the two federal governments whereby Canada would agree to take measures to nullify the effect of a countervailing duty. This would not preclude a continuation of the legal case. The second option was for a termination agreement that would halt the legal proceedings by the industry plaintiff in the U.S. The outcome, a Memorandum of Understanding (MOU) signed on 30 December 1986, raised considerable controversy in Canada, but succeeded in terminating the U.S. suit. Canada agreed to collect a 15 percent export charge on softwood lumber shipped to the United States, and to consult with the Americans about provincial charges designed to replace the export tax. This kept the tax revenue in Canada, while having the same effect on Canadian producers of an import duty. While not mentioned in the MOU, the implementing legislation in Canada stipulated that the export charge revenue, minus administrative costs, would be returned to the province of the originating shipment.[57]

Both the process by which Canada decided to negotiate a settlement and the terms of that settlement raise interesting issues about the role of the provinces in trade disputes. A fierce internal debate arose in Canada as to whether to pursue this "termination" agreement, culminating in a federal-provincial discussion at the Annual First Ministers' Conference on the Economy, held in late November 1986 in Vancouver. The issue dominated the other business of the conference. The deadline for reaching a "suspension" agreement had already passed. The plodding pace of building consensus with the provinces probably meant that the option could not have been exercised. In the end, the federal government achieved the consent of nine provinces to proceed with a termination agreement. The one province that could not be a part of the consensus was Ontario. Premier Peterson argued for a continued legal contest on the merits of the case, rather than what his government perceived to be the capitulation to American political pressure to settle out of court. He raised as well questions about the constitutionality of a proposed federal export tax. Ontario was joined in its opposition to a negotiated termination by prominent interests in the Canadian forest industry.[58] Industry spokesmen complained bitterly that they had been left out of the process in the effort to get provincial consensus, and that the revenue interests of the provinces were being put ahead of the long-term health of the forest sector.

That the industry's views did not prevail attests both to the political clout of the provinces and the jurisdictional complexities of the dispute. The Government of British Columbia as the main culprit in the U.S. eyes, and with the most to lose from a countervailing duty, had the ability and indeed threatened to cut an independent deal with the U.S. lumber interests. These threats went a long way to undermining any Canadian position based on fighting the good fight before the Department of Commerce. This is not to sit in judgement on the outcome. A good case can be argued that the negotiated "termination" settlement indeed made the best of a bad situation. However, one can also argue that Canada might have been better served by a more cohesive front.[59]

If the process of domestic negotiations to settle this dispute are revealing, so too was the settlement itself. Throughout the previous decade, Canadian provinces had vigorously resisted federal government taxes on resource exports. The federal bill implementing the MOU could have been challenged on the constitutional grounds that the real purpose of the bill is to alter provincial stumpage practices, but the legal arguments are by no means one-sided.[60] In any case, the political issue was considerably muted by the return to the provinces of the export charge revenue. What is perhaps more problematic is the requirement in the MOU that the United States administration be consulted on provincial replacement measures. A side letter to the U.S. producers made it clear that the administration would fight any attempt by the provinces to use the export charge revenue to otherwise support Canadian lumber production. As Constance Hunt has written: the situation illustrates the "high cost of provincial independence in the face of protectionism and world market forces."[61]

To date, Canada and the U.S. have agreed to the replacement stumpage regimes in British Columbia, to exempt the Maritime provinces and Newfoundland, and to reduced export charges for Quebec producers. Nonetheless, a uniform approach across all provinces has been impossible to achieve, given the variety of crown forest management practices and the forest sectors mix across Canada. Another major issue is the policy preference of at least one province, Ontario, to have nothing to do with negotiating stumpage with the U.S. administration. The industry for its part generally favours the single export charge as a simpler and less costly alternative than increased stumpage. In the downturn now facing the North American lumber market, pressure is on to renegotiate the terms of the MOU. John Crosbie has given the U.S. notice that it seeks to re-open the issue, which may, as well, raise many of the same issues adressed here.

In sum, the continuing problems of the softwood lumber dispute get at the heart of the provincial role in trade policy. The federal government cannot dictate terms to the provinces; neither can it manufacture consensus. Debate among the provinces and threats of independent action by individual provinces precluded certain strategic options for Canada — either by contributing to a delayed response or by public positions that weakened the overall Canadian case. The emphasis on federal-provincial consultation can freeze out consultation with the private sector. In the end, however, a domestic solution to a very difficult trading problem was found, and through a method (export tax) that only a few years before might have provoked a bitter debate.

LIQUOR BOARDS

The liquor boards case concerns a complaint by the European Community, taken through the GATT dispute settlement procedures, that Canada had not lived up to commitments made during the Tokyo Round and previous commitments under the GATT to liberalize trade in alcoholic beverages. At issue were GATT obligations including a 1979 Statement of Intent signed by the provincial governments concerning the practices of their liquor boards that regulate the consumption, sale and distribution of alcoholic beverages in Canada.

The Statement of Intent had been considered one of the successes of the Tokyo Round. Michael Hart, writing in 1985, was able to say that: "(w)hile there have been difficulties in the past few years regarding the interpretation of provincial commitments, and while the federal government has had to act as a middleman...these letters of intent marked the first time a matter of purely provincial administration was negotiated successfully in a multilateral trade negotiation." The commitment was credited with improving market access for Canadian distillers in the United States and Europe.[62] In the past few years however, the "difficulties" have come to totally eclipse the achievements of the Statement of Intent. Problems with the European Community over the interpretation of the Statement of Intent led to a more protracted dispute about whether or not Canadian provinces were living up to their GATT commitments. It may have been that the European Community misunderstood or misinterpreted the extent of the provincial undertakings. Nonetheless a number of provinces were engaging in practices that were arguably in violation of the 1979 statement, at least. Ontario, in particular, by virtue of its market size, and its protectionist stance towards local wine production, was the focus of EC concern. At issue were differential mark-ups for domestic and imported wines and other beverages, but also the listing, handling and distribution of imported products.[63] Following lengthy discussions, which failed to resolve the dispute, the EC sought and obtained Canadian concurrence in 1984 to take the dispute to a GATT panel, which reported on the issue in October 1987.

At the heart of the panel's review of the case was the "federal state clause " of the GATT (Article XXIV (12)) Canada argued before the panel that the "reasonable measures" required of the federal government in Article XXIV(12) did not extend to forcing the provinces to comply, and that in any case, such a constitutional initiative could not be guaranteed of success.[64] The EC argued that the provinces violated GATT commitments and that the federal government had the power to force the provinces to keep those commitments. Upon hearing both sides, the GATT panel concluded that Canada (plural) did indeed violate its commitments, but wisely gave Canada a year to reach agreement with the Community on compliance, without stipulating how it should do so. Despite the overlapping of the issue with the equally contentious issue of U.S. access to Canadian markets as provided in the FTA, a final agreement was signed with the EC to settle the dispute on 20 December 1988.[65] The agreement provides satisfaction to the EC complaints that centred mainly on wine. Beer is covered, but only to the extent of freezing existing price mark-up differentials and extending the principle of national treatment to listing practice. The provincial distribution system for beer is not affected.

This dispute involved legitimate Canadian domestic interests, in particular the grape growers and wineries in British Columbia, Ontario and elsewhere. These interests could and did argue that the EC complaints were not the whole issue, especially when European agricultural subsidies are considered. However, the chief EC complaint was about wine. Those provinces which do not produce wine, but for whom barriers to the import of beer constituted an important provincial policy, were anxious to see the dispute settled without unduly involving beer. The federal government had concerns about easing adjustments in the domestic industry, but also faced an escalating trade dispute with the European Community that would affect broader relations.

As a result of these conflicting interests, federal-provincial consultations to reach a settlement, both before and after the GATT panel report, were long and difficult. To what extent the domestic debate hindered a quick settlement of the dispute in the early 1980s is open to speculation. Had the dispute been settled before going to the GATT panel, the precedent would not have been established — a precedent now being pursued by U.S. beer interests. In any case, by the second round of negotiations in 1988, the federal government was obviously determined to reach an agreement with the European Community. Extensive negotiations with the provinces and industry again occurred, including three sessions with the EC at which provincial representatives were present. The final agreement reached with the EC on 20 December 1988 was made with the knowledge and tacit consent of a majority of the provinces, although Ontario apparently reserved its support until a final settlement was reached on wine adjustment measures in March 1989.

Once again, as with the other negotiations and disputes examined by this paper, the consultative process played an important role in achieving a trade policy result. However, in the context of this paper the more important issue is why the provinces, having made a commitment in 1979, dragged their heels on abiding by that commitment in the succeeding years. Scott Fairley has written that it was the absence of a continuing institutional framework that led the provinces to renege on their commitments. "The immediacy of constant local economic and political pressures" prevailed over the more distant considerations of trade policy, once the Tokyo Round consultations concluded.[66]

Regardless of how or why the provinces did not live up to their commitments, the enforcement of these commitments becomes a central issue to the EC. The Statement of Intent was clearly not legally binding on the provinces, but as the GATT Panel Report has concluded, Canada is nonetheless on the hook. The GATT does not, of course, force Canada to take action against the provinces. It does mean that where GATT parties can demonstrate the nullification or impairment of their rights, they have in turn the right to take retaliatory measures of equivalent effect. In these latter circumstances, the regional incidence of the benefits derived from the protectionist practices may not coincide with the application of the costs of retaliatory measures.

In any case the resulting impasse has been detrimental to Canada's trade relations with the EC, and its reputation in GATT, not to mention the precedent which the dispute sets for future attempts to reach provincial agreement on such commitments. As Ivan Bernier has written, the outcome of the GATT panel report on this case may have "closed the door" to the use in the future of agreements reached among the provinces for trade commitments, which depend in the final analysis on the loose terms of Article XXIV(12) for their implementation.[67] This raises the question of whether Canada should adopt a more certain means of ensuring provincial compliance with trade commitments. We return to this issue in the concluding part of this paper.

These two disputes illustrate some common problems, and opportunities. Once again, federal-provincial consultations played an important role in trade policy matters, although in the lumber case, this appeared to be at the expense of private sector consultation, which need not have been the case. Nonetheless, weaknesses in the process emerge, such as the lack of an institutional framework for follow-up on provincial commitments, the difficulties that emerge when a common Canadian front is perforated by independent provincial action, and the continuing problem of how to achieve binding commitments for trade policy concessions within provincial jurisdiction. These issues will be discussed further in the last part of this paper.

Experience in other Federal Countries

Canada is not unique in having to greet the world with a federal face. A selective review of the experience of other federal countries will demonstrate, however, that federal constitutions and political systems can vary considerably in how they handle the role of their constituent units in national foreign relations and the growing role of subnational governments in the international arena. First published in 1946, Kenneth Wheare's widely cited comparative study, *Federal*

Government, concludes a survey of federal governments and the control of foreign relations with the gloomy statement: "Federalism and a spirited foreign policy go ill together."[68] Today all nation-states must contend with a complex and competitive domestic environment in presenting a coherent position to the world community. Federal countries differ from unitary states in the constitutional and other provisions that ensure a role for their subnational governments. This role varies from participation in foreign policy formation, to treaty ratification, implementation and administration, and in the representation of regional interests in the domestic policy debate over international matters, including trade. The following discussion reviews the situation in three federal countries, two of which are important trading partners for Canada, and all three of which have advanced industrial economies: the United States, Australia and the Federal Republic of Germany.

UNITED STATES

When compared to Canada, the United States is much more centralized in its assignment of constitutional authority to undertake trade policy and relations. The power to enter into treaties lies with the federal executive, and legislative ratification rests with the federal Congress. Furthermore, a treaty must pass a ratification vote in the Senate by a two-thirds majority in order to take effect. Moreover, the federal government's "commerce" power has been interpreted, as early as 1824 by Chief Justice Marshall, as overruling most state measures that infringe on the freedom of commerce.[69] Thus treaties in trade matters have the full force of law when ratified by Congress and have until now prevailed over any conflicting state laws.

This does not make trade policy any less difficult in the United States than in Canada. The separation of powers doctrine ensures that trade agreements must be the joint creatures of Congress and the administration. The president and the administration can negotiate a trade agreement, but can give no guarantee of its acceptance by the Senate. While this requirement has led to the proclivity for "executive agreements" that do not require Senate ratification (U.S. accession to the GATT was for years achieved only by executive agreement, as Congress refused to ratify the GATT until the 1980s),[70] trade matters have been jealously guarded by Congress. In the past decade or so, the preferred route to trade agreements has been through an intense and often difficult consultative process between administration negotiators and Congressional committees. Negotiations that proceed through this route can then be submitted for ratification on a take it or leave it basis as embodied in the "fast track" process.[71] The experience with the negotiations over the FTA amply demonstrated the important role of Congress, especially the Senate, in U.S. trade relations.[72]

Where does all of this leave the states? Certainly in the American federal system the Senate, whose members were originally appointed by the states but are now directly elected, has taken on the role of representing regional interests in national deliberation. This has not prevented the state governments themselves from pursuing a range of interests in the international arena.[73] However, executive federalism as practised in Canada is not the predominant mode in the United States for bringing state concerns to bear. The National Governors' Association and other associations of state legislators and agencies express their views on trade policy,[74] but in the main, they lobby Congress as everyone else does. For the recent bilateral trade negotiations with Canada, the U.S. administration did establish an Intergovernmental Policy Advisory Committee on Trade, which included some state governors, but also included some mayors and other state and municipal officials. It met on an ad hoc basis and no more than quarterly during the Canada-U.S. negotiations.[75] By all accounts, it did not play as significant a role in shaping the U.S. position as the federal-provincial consultation process did for Canada. The purpose of the consultations seemed to be to mainly alert the states to issues that were best addressed through Congress.

This is not to say that while the states are not as intensely involved in the trade policy process, their direct interests are not respected. In recent years the administration has more often than not shrunk from impinging on state authority, not for lack of jurisdictional clout, but for more broad ranging political reasons.[76] It appears, for example, that in the final stages of the negotiation of the FTA the U.S. administration withdrew its support for a Canadian proposal to conclude a government procurement deal that involved the state and provincial governments, because of its concern with getting such a package through Congress.[77] Thus American federalism indeed intrudes upon American trade policy, if perhaps in more subtle ways than in Canada. Notwithstanding the impressive concentration of power on paper, trade policy has become very much the art of the possible in the contemporary United States.

AUSTRALIA

Australia presents another example of a rather centralized approach to trade policy matters, but with a few features that may be more applicable to the Canadian case, as both countries are federal states with parliamentary forms of government. Australia deliberately chose the American model when designing the division of powers between the Commonwealth and the states at the turn of the century. Unlike Canada, Australian states do not have a long list of exclusive matters of jurisdiction but have, in the main, concurrent powers with the Commonwealth government. As a result, they have both an American-style treaty power and commerce power vested in the central government. While treaties do not automatically have the force of law in Australia, the Commonwealth has exclusive power to make laws in relation to international affairs. Judicial interpretation has broadened this power to include the implementation of treaties in subjects of state jurisdiction. This has arisen in part because of the constitutional division of powers where federal jurisdiction, once exercised, can pre-empt concurrent state powers. In Canada it is the existence of the long list of exclusive provincial powers that prevents this. Indeed, since the 1936 High Court decision in *Rex v. Burgess*, the Commonwealth has been able to use the treaty power to intrude into state jurisdiction where otherwise it could not. Lord Atkin in 1937 recognized that such a result in Canada would be destructive of a federal balance created by the division of powers. Similar constitutional constraints do not exist in Australia.[78] Indeed, recent High Court judgements have reinforced the trend, as for example, the Franklin River Dam case, where a hydroelectric project in Tasmania was stopped by the Commonwealth government by invoking its signature on a UNESCO treaty for the preservation of World Heritage Sites.[79] So entrenched is the concept of central dominance over treaty implementation that the Commonwealth government achieved the agreement of the states to a declaration that Australia "does not favour the inclusion of federal state clauses in treaties."[80]

The commerce power in Australia is also drafted in Australia to be more in the Commonwealth's favour, so that in matters of trade agreements, Australian states have practically no jurisdiction in the array of nontariff barriers that Canadian provinces exercise. This was the deliberate intention of the framers of the Australian constitution to avoid what was termed the "barbarism of borders" in Australia in the 1890s.

Despite these jurisdictional resources, the Commonwealth government does face some competition in the articulation of Australian interests in foreign policy. Regional interests, as in the Canadian case, tend to be represented by the state governments, and the tendency to executive dominance in the parliamentary form of government has led to a similar rise in the processes of executive federalism.[81] Thus the Australian Premiers' Council (which includes the Commonwealth prime minister — i.e., the equivalent of the Canadian First Ministers' Conference) adopted a set of principles and procedures in 1977 (amended in 1982) to provide for intergovernmental consultations on treaty negotiations.[82] This process allows state representatives to be observers or members to international delegations, although at the discretion of the Commonwealth government, which has rarely been granted.

In any case, the state governments have been only infrequently consulted on trade negotiations.[83] Here the operative factor appears to be that trade is exclusively in the hands of the central government. Executive federalism — otherwise as well developed if not more so in Australia than Canada — therefore is not a major factor in Australian domestic politics on trade. As a final point of comparison, it would appear that the elected Australian Senate has not taken on a significant role in terms of protecting regional or state interests in trade or other foreign policy matters. The Australian senate has been essentially a party house, and where it influences foreign policy it does so on largely partisan grounds.

FEDERAL REPUBLIC OF GERMANY

The Federal Republic of Germany is another example of a federal state with constitutional provisions that centralize legal jurisdiction for foreign policy in general and trade policy in particular.[84] That having been said there are a number of features in the operation of the federal system in the FRG that merit attention.

The Federal Republic is perhaps first and foremost a form of administrative federalism. Much legislative jurisdiction is concentrated in the federal parliament, and certainly jurisdiction over the subject matter of most trade issues is in federal hands. However, the administration of all laws is undertaken by the Land governments. Thus, while the federal government can negotiate treaties and pass them into law, their detailed implementation depends upon the cooperation of the Länder. This can have important trade effects where regulatory regimes are involved, where standards are devised and interpreted or where discretion is typical in administrative practice.

The potential for difficulty is met through extensive consultation with the Land governments through direct intergovernmental relations and by the role of Länder representation in the upper chamber of the federal parliament, the Bundesrat. The Land governments are permitted (upon the consent of the federal government) to enter into treaties in matters within their jurisdiction, a provision even the Canadian constitution does not provide. This capacity has not been widely exercised, but some Land governments have concluded cultural treaties with a number of countries. The Länder agreed in fact in 1957 that the foreign service of the federal government would negotiate such agreements on their behalf![85] A Permanent Treaty Commission exists to facilitate intergovernmental consultation regarding treaties, or parts of treaties that fall under Land jurisdiction (most notably, education and culture). It consists of representatives of the Land governments who participate in consultations with the Foreign Ministry before and during treaty negotiations.[86]

As for the Bundesrat, which is composed solely of delegated elected officials of the Länder governments, often led by the Ministers-President (i.e., Canadian equivalent would be premiers) this chamber also has a role in ratifying treaties and approving any implementing legislation.[87] Over some types of treaties that would affect certain basic Länder rights, the Bundesrat has an absolute veto, and over the rest a suspensive veto. The threat of veto induces the federal government to negotiate the details of legislation with the Bundesrat. Although different in form, the role of the Bundesrat with respect to treaties is similar to that of the U.S. Senate.

Finally, the respective roles of the federal government and the Länder in trade policy are being affected by the evolving relationship with the European Community (EC).[88] Both the federal and Land governments have been giving up sovereignty to the EC, through successive integration over the past 30 years. Not least of these in terms of significance to Canadian trade relations is that the European Commission and not the member states, has primary jurisdiction over external trade policy. European integration is now accelerating in the push for a single market by 1992. The result in recent years has been to tip the balance in favour of the federal government, which has an advantage over the Länder in having at least a seat at the European Council where matters affecting the Länder are discussed. Concerns about the role of the Länder coalesced in the debate over the FRG's *Single European Act*, passed in 1986. The Act provides for notification to the Länder of European matters, the consideration of Bundesrat policy statements on these matters, and the possibility of Länder representatives at EC meetings. It is important to note that in any case any provision to transfer Land powers to the Community would require a majority vote in the Bundesrat.

Space does not permit a more lengthy discussion of the complex and changing relationships between "Bund," "Länder" and Brussels. These relations are proceeding on a number of fronts. They include the development of a direct relationship between the European Commission and the Länder. EC president Jacques Delors speaks of a "Europe des regions," i.e., recognizing regions within current nation-states as eventual constituent units of a European Federation, striking a responsive chord in the Land governments. Whether or not the European strategy of allowing regional flexibility in decision-making will achieve the desired unity through diversity, has many parallels for Canada. Not least of these parallels is the importance of regional input to central decision-making for the avoidance of trade destructive practices of the regional governments.

In conclusion, there are many features of the comparative federal experience that could be instructive for Canada in reviewing the role of the provinces in trade policy. Some of the constitutional provisions of other countries will not be readily adaptable to Canadian practice, even if amending our constitution was an easy thing. These include the strong commerce power and the self-executing treaty powers that prevail in each of the three countries examined. Another more fundamental reform that might merit consideration, albeit not in the short term, is the whole function of regional representation in the federal government, in particular in the second chamber of the legislature, i.e., Senate reform.

Other features of the federal system in these countries relate to the political and institutional practices of intergovernmental relations, from which some ideas might be drawn. These include the formalized procedures for treaty consultation, and the provisions where unanimity is not always required in the ratification of treaties such as in the Bundesrat of the Federal Republic of Germany. These and other lessons from the comparative experience will be discussed in the next and concluding part of this paper.

Towards More Effective Trade Policy

SUMMARY OF CANADIAN EXPERIENCE AND LESSONS FROM ABROAD

The purpose of this paper has been to trace the evolving role of the provinces in Canada's trade policy. In so doing, the intent has been to examine the underlying causes for such a role and to assess the impact of federal-provincial relations on the effectiveness of Canada's trade policy through the experience of recent trade negotiations and disputes. The experience of other federal countries has also been examined. Three questions were posed at the beginning. How has the provincial role evolved? To what extent is Canada unique in providing this role? Does this role provide problems for effective trade policy for Canada? A summary of the answers produced by this analysis will provide a backdrop for some concluding comments on the continuing federal-provincial agenda on trade policy, and options for future consideration.

The role of the provinces in trade policy in Canada arises from both worldwide trends and a unique combination of domestic factors. The causal factors that Canada shares in common with other countries is an increasing economic interdependence. This interdependence is both the result of and a contributing factor to a broadening of trade policy far beyond the narrow confines of tariffs to embrace the now expanded role of the state in the economy. Interdependence is also a factor in the increasing role of subnational governments in the international economy, with direct and indirect impacts on trade policy. On the domestic front, Canada deals with these external factors from its unique institutional position as a federation. Canada, especially as compared with the United States, Australia and the Federal Republic of Germany, exhibits a marked degree of constitutional decentralization with respect to treaty implementation, and a much less broadly defined central government power over trade and commerce.

Canada shares with other countries, especially the United States, a significant divergence of regional interests in trade policy. Where it differs from the United States, and to a degree from the FRG, is in how these regional interests are expressed or accommodated. In Canada the primary role of regional representation lies with the provinces, contrasting with the strong role of the Bundesrat in the Federal Republic of Germany and the Senate in the United States. The combination of a parliamentary system of government with a federal constitution means that in Canada, as in Australia, intergovernmental relations are dominated by executives, both elected and appointed. Where Canada is particularly unique is in the role that intergovernmental relations plays, to the predominance over other domestic relations, in the formation of trade policy. This arises in turn from the role that provinces play in representing regional interests in national matters, and from the constitutional authority over aspects of treaty implementation and over some of the content of the broadened trade policy agenda.

The evolution of this role in practice demonstrates its strengths and weaknesses for an effective Canadian trade policy. Recent Canadian experience demonstrates that the role of the provinces in the "domestic negotiations" over trade policy has evolved from being one among many constituent interest groups to that of a privileged, even partnering role with the federal government. This role has generally not extended to providing provincial representatives with a seat at the trade negotiating table, although in the case of the liquor board dispute, the effective negotiation of a settlement with the European Community included sessions where the provinces participated in direct discussion with the EC. Detailed consultation with the provinces during the negotiating stage for recent multilateral and bilateral trade negotiations has nonetheless become an essential ingredient to achieving effective results for Canada. The technical advice of the provincial representatives, and their detailed knowledge and advocacy of local economic interests have been valuable to the development of a common Canadian position. Where there is no continuing forum for the exchange of views and information, trade policy decisions at either the federal or provincial level will not adequately take account of the obligations of interdependence. Such unilateral actions fragment the Canadian position with damaging results (there are examples of this in both the softwood lumber dispute and the liquor boards issue.) In practice, consultations with the provinces have not always been easy for federal trade negotiators to accept or to manage. Mutual professional considerations among officials, and the development of trust relationships have contributed to effective consultation, whereas on occasion the intrusion of politically motivated positions on high profile issues have prevented meaningful dialogue and input.

A more important limitation of the role of the provinces arises from the inherent limitations of federal-provincial consultation itself. There are still no formal rules to apply to decision-making in intergovernmental relations in Canada. This applies with respect not only to relations on trade policy, but to most other areas of intergovernmental relations as well. The broader implications of this structural factor are discussed below. Here it is important to note that the lack of any rules other than consensus or unanimity in obtaining provincial consent is a constraint to developing an effective Canadian position on trade matters. Consultation is not decision-making. And even where provinces have decided to bind themselves to trade commitments, as with the 1979 Statement of Intent on liquor board practice, the lack of an enforcement mechanism was partly to blame for the ensuing trade dispute with the EC. In the absence of a more formal means of reaching binding decisions with the provinces, the federal government may be faced with the more aggressive exercise of its legal jurisdiction, which in turn could upset the balance of interests in the federal system. The lessons of the Australian case, where the states have by comparison no such role in the formation of trade policy, are instructive of the consequences of centralized jurisdictional resources. At the same time, some of the institutionalized intergovernmental practices in both Australia and the Federal Republic of Germany with respect to foreign treaties may have some applicability to Canada. We will return to these examples when reviewing the options below.

THE CONTINUING TRADE AGENDA

The need to define the role of the provinces presents a continuing challenge in light of the current trade agenda. The prospects for the conclusion of the Uruguay Round and the unfinished business of the Canada-United States Free Trade Agreement provide a number of issues to be addressed.

In the Uruguay Round, which is scheduled for completion at the end of this year, federal-provincial consultation has become an important element in forming the Canadian position. There are certainly a number of regionally sensitive issues, such as agriculture, and textiles and clothing, where an early and detailed exchange of views with the provinces prior to the tabling of positions in Geneva may be effective in ensuring that an ongoing consensus around these positions is maintained. Thus far the negotiations have not proceeded with the highly charged political atmosphere that characterized the "free trade" debate. This is not to argue for no public debate, but rather to argue that the merits of trade policy options can be more carefully considered without the high profile.

At least three of the Uruguay Round agenda items may ultimately require consultations that are aimed at more than just keeping the lid on. These are government procurement, services and investment, where provincial jurisdiction may be affected directly by the results. If there is to be any substantially new liberalization in procurement practices beyond the entities listed in the 1979 Code, provincial government procurement, in particular certain crown agencies such as hydro corporations, will be a prime target of our major trading partners. On services, an entirely new agreement is being considered that could go beyond the sort of prospective involvement of the provinces in the FTA. In the investment area as well, at least some of Canada's major trading partners have identified provincial practices for inclusion in a new set of rules prohibiting trade-related investment measures. The federal government for its part will be looking to the provinces to agree to put their measures on the table, and will be considering ways and means to ensure other contracting parties that what is on the table can be delivered. In so doing Canada may well take on, where possible, a stronger undertaking with respect to provincial governments such as is provided by Article 103 of the FTA.

The other set of issues where the provincial role continues to present challenges is in the implementation of the FTA. Here there has been a continuing debate among the federal and provincial governments about the role of the provinces in continuing negotiations mandated by the FTA, in the dispute settlement processes of the FTA, and in general trade relations with the United States under the Agreement. There are indications that the governments may be close to agreeing on a set of procedures, which would be most welcome. A specified institutionalized role for provincial governments in FTA implementation will go a long way towards sustaining the momentum of provincial commitment to the FTA exhibited during its negotiation.

Nonetheless there are a number of issues to be overcome. The provinces want to have a role in the "political oversight" of the Agreement, through the Canada-United States Trade Commission headed by the Canadian Minister of International Trade, John Crosbie and the United States Trade Representative, Carla Hills. This commission will play a vital role in solving minor problems before they get worse, and in coordinating genuine disputes through the procedures in the FTA. The provinces want some assurance that issues of direct interest to their regions will be addressed in this process. The issue of the dispute settlement procedures is more difficult. The provinces want a mandated role in the settlement of disputes involving provincial measures and direct provincial interests. The debate with the federal government surrounds the definition of what constitutes provincial interest, and the sensitive question of whether provincial representatives will be allowed to present their views directly to dispute panels. The history of the two disputes reviewed in this paper illustrates that some sort of mandated role for the provinces may help to settle disputes in ways that maintain an integrated Canadian position. There are also instances where the direct representation of provincial views would be useful.

Finally, the role of the provinces in the continuing negotiations over substantive rule-making is being discussed. While the chief among these are the negotiations to be completed within five to seven years on subsidies and unfair pricing, other agenda items include the negotiation of standards and phytosanitary regulations, agricultural trade practices and the possible extension of the sectoral liberalization of services.[89] Here one is faced with the same sorts of considerations that prevailed over previous rounds of negotiations. Detailed consultation procedures would seem to be essential. However, the problem of reaching agreement on binding commitments involving the provinces remains.

OPTIONS FOR THE FUTURE

The preceding discussion of the continuing agenda begs several questions about fundamental approaches to intergovernmental relations in Canada. In the face of global economic challenges there are perhaps two models of how to organize a Canadian response. One would dictate a centralized response by a federal government capable of acting authoritatively and without constraint to meet the global challenge. The other model would argue that the global challenge is so pervasive that it can only be met by a collaborative response of both federal and provincial governments.[90]

For the practical purposes of Canadian trade policy it may be instructive to review not so much the merits of one model over the other, but rather to look at differing types of intergovernmental relations that could be employed in trade matters in order to draw out possible options for the future consideration of both federal and provincial governments. These types are organized into three categories: (a) unilateral action; (b) improved consultation and collaboration; and (c) reaching binding decisions.

Unilateral Action

There are, of course, many arguments against any continuation or elaboration of the consultative approach to trade policy. Michael Hart wrote in 1985 that the practice of requiring provincial consensus will lead to lowest common denominator results, will weaken federal constitutional authority, and will invite foreign influence on provincial governments. The federal government must remain the "final arbiter," according to this view.[91]

There is in the broad literature on intergovernmental relations, a recognition that unilateralism has its advantages. It avoids what a German scholar has called the "joint decision trap," where the need for joint decisions is needlessly constraining on both sides.[92] As a broad strategy, of course, this was the intergovernmental policy of the federal government under Trudeau's leadership from 1980 to 1984. It has the virtues of being a more accountable, and thus more democratic form of policy-making. To the extent to which it succeeds in its goals, it can make for more effective policy.

Here is the rub. Unilateral policy decisions run enormous risks of conflict generation. In legislative terms, a government must be sure of its jurisdictional ground and be willing to aggressively defend it. Private actors, including significant constituent interest groups, are often caught in the ensuing federal-provincial cross-fire.[93] In trade policy, the risks are that trading partners will exploit the conflicts to the detriment of overall Canadian interests.

Unilateralism by either federal or provincial governments should be discounted as a comprehensive approach. For the exercise of trade policy, it is not completely without merit in individual cases. Recent experience demonstrates that in the crucial final stages of negotiations with trading partners, unilateral decisions must be made. The primary role of the federal government to account for such decisions places on it the burden to make these decisions. In the absence of more certain means of reaching binding federal-provincial decisions, the final act must remain with a single actor.

Improved Consultation

In its most extreme form, "unilateralism" can mean that governmental actors take decisions without any consultative relations with other governmental actors. In reality much of what constitutes the consultative form of intergovernmental relations is a means of improving the quality of decisions that, at the end of the day, are made in federal or provincial governments acting within their own jurisdiction. As one analyst has put it, "direct bargaining is less important, in some contexts, than parallel actions that are coordinated by independent mutual adjustments."[94] Indeed, the consultation process then becomes part of a broader problem-solving approach, rather than as a cockpit for confrontation.

It is thus important to underline the conditions required to build constructive consultative processes. The "routinization" of consultation is seen by many analysts as an important component in the development of professional, trustworthy and productive relations.[95] While the development of relations among technocrats may not be perceived by all as a positive development, there is a long history of productive trade relations by national representatives through the GATT and elsewhere, which could not be accomplished without the work of a cadre of similarly-minded professionals. A similar or less refined development for intergovernmental relations on trade policy in Canada is to be welcomed. Conversely, any intergovernmental consultation that relies solely on political contacts will, not surprisingly, be incapable of reaching agreement on technical matters and will instead maintain the salience of political issues that are less amenable to resolution through consultation.

There is one problem in the development of routine professional intergovernmental relations. This relates to the unequal resources available to individual provinces to participate in the task. The quality of consultation depends in part on the quality of views and information exchanged. Does this put the smaller provinces, with their typically smaller bureaucratic resources, at a permanent disadvantage? There is no doubt that the largest provinces of

Ontario and Quebec have bureaucratic resources to devote to trade policy analysis far beyond those of say Saskatchewan or Newfoundland. Nonetheless, size does not always matter so much as how available resources are used. A small province with a well-founded definition of its interests and an aggressive strategy of advocacy can have just as much influence in relation to its needs as have the larger provinces.

In intergovernmental relations, where all ten provinces have formal equality, the weight of influence on policy can shift the Canadian position, if ever so slightly, towards the interests of the less populated regions of the country. This need not be viewed as a constraint to effective trade policy. In any case, in the context of consultation, which is not decision-making, the emphasis is still on influencing rather than determining policy results.

Reaching Binding Decisions

Throughout this paper, the problem of how to reach decisions that will bind Canadian provinces to trade commitments has been raised. From the provincial perspective, decision-making is a two-way street. The more formal the requirement for a commitment on the part of the provinces, the more input the provinces should have in the decision to make that commitment. This input is met in part, but not wholly, by the consultative process.

The ultimate expression of provincial input would be "ratification." The concept of ratifying trade agreements is not part of current Canadian constitutional practice. Treaties achieved by royal prerogative in Canada do not require ratification. Legislatures become involved only to implement treaties. However, Canadian practice might be modified in order to require treaties to be ratified, as a means to strengthening the legitimacy of public consent. When this has been proposed, such as by the Macdonald Commission in 1985, it has usually been a part of a broader effort to ensure that the ratification process has the end result of giving treaties the full force of law in both federal and provincial jurisdiction.

There are a number of different (although not mutually exclusive) options. The first would be to require, by constitutional amendment, that treaties only have effect on provincial jurisdiction if they receive the support of the majority of provincial legislatures (usually invoking the general amending formula of the *Constitution Act, 1982*, which requires a two-thirds majority with 50 percent of the population).[96] The second option would see the provincial legislatures by-passed and instead require ratification by a reformed Senate, which would more effectively represent the provinces than the current Senate does. This is the practice in the United States and the Federal Republic of Germany.[97] Finally, a more complicated proposal has been made to establish a "Federal-Provincial High Commission on Treaties and International Agreements," delegated with "full powers to negotiate, conclude and sign for and on behalf of Canada, all treaties."[98]

Apart from "ratification options," there are other constitutional amendments that would simplify the decision-making process. These are those that would strengthen federal jurisdiction with respect to treaty implementation, and/or the trade and commerce power. Such overt constitutional change seems unlikely. Progress in that direction could nonetheless be made through judicial review, as the courts may attempt to redefine the *Labour Conventions* case, and may already be redefining trade and commerce.[99]

All of the above options require constitutional reform, which in the present climate can at best be relegated to longer-term consideration. Of more immediate potential for reaching agreement on binding decisions is the intergovernmental agreement. Here again, there is a legal constraint. Intergovernmental agreements in Canada do not have any constitutional status except where they have been expressly entrenched by constitutional amendment. Otherwise, there has been very little experience in enforcing intergovernmental agreements, save where they are contracts enforceable by civil law (which may not always be applicable). Legal scholarship suggests that federal-provincial agreements could be made more binding through the increased use of contractual language in drafting, through provisions for adjudication, mirror legislation and other devices.[100]

One of the virtues of intergovernmental agreements is their flexibility. They can be the means for achieving unanimity; they can also represent bilateral or regional understandings. This latter option need not always be a constraint on trade policy. There are numerous instances where uniformity of commitments across all provinces need not be the rule. Trade agreements are replete with special exceptions, grandfathering and unique circumstances. Canadian constitutional and intergovernmental practice is similarly marked by a flexibility with respect to bilateral or regional arrangements, including "opting-out."[101] There is no reason why trade concessions need always impinge on all provinces uniformly. This is especially so in Canada where four provinces (Ontario, Quebec, British Columbia and Alberta) are responsible for 80 percent of all trade. Trading partners may well be satisfied with concessions from these four provinces, while some or all of the smaller provinces could be left out. This assumes of course that the concessions at issue do not involve externalities or mobile factors of production, which could vitiate the concessions. It also assumes that the exceptions arise for legitimate reasons, and that the costs and benefits of concessions are balanced overall. Otherwise, political consensus to proceed in such a fashion would never be forthcoming. Nonetheless, once flexibility is recognized as an operating principle, the chances of reaching binding agreements, and avoiding a "joint decision trap," are increased.

In conclusion, the purpose of these comments on reaching binding decisions is not to recommend any particular reform proposal. Rather, the objective is to present a range of options from which unique and changing circumstances will dictate the appropriate choice. The point remains, however, that Canada has not yet come to terms with the important issue of reaching binding commitments for all the jurisdictions of our federation in the broadened context of trade policy. The interdependent environment of both our global trading relations and Canadian federalism demands that we do better.

NOTES

*Research for this paper was made possible in part through funding provided to the Institute of Intergovernmental Relations from Power Corporation, and from the Canada-United States Project at Queen's University, funded by the Donner Canadian Foundation. The author would also like to acknowledge the research assistance of Dwight Herperger in the preparation of this paper. Thanks are also due to Ron Watts, Murray Smith, Dwight Herperger and to a number of provincial and federal officials for their comments on earlier drafts, including the paper as presented at Mont-Gabriel. The author is solely responsible for any remaining errors of fact or interpretation in this paper.

1. For general literature on the concept of "subnational units" in international relations see the contributions by Daniel Elazar, Ivo Duchacek and Earl Fry in I. Duchacek, D. Latouche and G. Stevenson (eds.) *Perforated Sovereignties and International Relations: Trans-Sovereign Contacts and Subnational Governments* (New York: Greenwood Press, 1988). See also Duchacek's *The Territorial Dimension of Politics: Within, Among and Across Nations* (Boulder, CO.: Westview Press, 1986), chapters 8, 9 and 10; and his *Towards a Typology of New Subnational Governmental Actors in International Relations* (Berkeley: Institute of Governmental Studies, 1987). For a broader perspective on the multiple roles of non-nation-state actors in the international arena see Robert Keohane and Joseph Nye, *Transnational Relations and World Politics* (Cambridge: Harvard University Press, 1972) and their "Transgovernmental Relations and International Organizations," *World Politics*, 27:1 (1974), pp. 39-62.
2. For a general overview see Kim Nossal, *The Politics of Canadian Foreign Policy* (2d ed.) (Scarborough: Prentice-Hall, 1989), chapter 9; and Elliot J. Feldman and Lily Gardner Feldman, "The Impact of Federalism on the Organization of Canadian Foreign Policy," *Publius* vol. 14, no. 4 (1984) reprinted in R.D. Olling and M.W. Westmacott, *Perspectives on Canadian Federalism*, (Scarborough: Prentice-Hall, 1988) pp. 257-78.
3. Thomas A. Levy quoted in Ivan Bernier and André Binette, *Les provinces canadiennes et le commerce international* (Quebec: Centre québécois des relations internationales/I.R.P.P., 1988), p. 8. See also "introduction" to this work.

4. For a good overview of the concept of interdependence in the global context see Sylvia Ostry, *Interdependence: Vulnerability and Opportunity* (Washington, D.C.: The Per Jacobsson Foundation, 1987).
5. See Keohane and Nye, *Transnational Relations*; Duchacek, *The Territorial Dimension*; also Feldman and Feldman, "The Impact of Federalism," pp. 257-58.
6. This term can be confusing. Canada is one of a number of countries that is both a nation-state and a federation of at least two separate "nations." In this paper the use of the term "subnational" will be restricted to discussion of expressly comparative analysis. Where the reference is to Canada, the term means provinces, and the latter word will be used as much as possible to avoid confusion. See, for example, the sub-title of Duchacek, Latouche and Stevenson (eds.), *Perforated Sovereignties*, "Trans-sovereign Contacts and Subnational Governments."
7. For a more complete discussion of these roles, a survey of the academic literature related to them and a case study of the evidence in respect of the Province of Alberta, see the author's unpublished paper "Canada's Provinces in the International Economy: A Survey of the Field," presented to the Nelson A. Rockefeller Conference on "Comparative Federalism:Changing Theory and Practice in Adaptive Canadian and American Federal Systems," Dartmouth College, 22-25 June 1989.
8. Duchacek's 1986 work, *The Territorial Dimension of Politics*, referred throughout chapter 8 to "permeable" sovereignties, and "percolation of boundaries." *Perforated Sovereignties* is the title of a collection of articles from a conference on this general theme held in November 1986.
9. For the rise of nontariff barriers from a Canadian perspective see John Quinn and Phillip Stayton (eds.), *Non-Tariff Barriers After the Tokyo Round* (Montreal: IRPP, 1982); Frank Stone, *Canada, the GATT and the International Trading System* (Montreal: I.R.P.P., 1984) chap. 15; and Fred Lazar, *The New Protectionism: Non-Tariff Barriers and the Effects on Canada* (Toronto: Lorimer, 1981).
10. For differing perspectives see reprinted articles by Alan C. Cairns, Garth Stevenson and R.A. Young, Phillipe Faucher and André Blais in Olling and Westmacott, op.cit., pp. 103-63. A balanced interpretation is provided by Donald Smiley, *The Federal Condition in Canada* (Toronto: McGraw-Hill Ryerson, 1987), pp. 3-11.
11. See Ronald A. Shearer, "Regionalism and International Trade Policy" in J. Whalley (ed.) *Canada-United States Free Trade*, Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada, vol. 11, (Toronto: University of Toronto Press, 1985), pp. 325-66.
12. Smiley, *The Federal Condition*, pp. 83-87. The term first appeared in his *Canada in Question: Federalism in the Seventies* (Toronto: McGraw-Hill Ryerson, 1972). A comparative analysis of the concept in Canada and other countries is provided in R.L. Watts, *Executive Federalism: A Comparative Analysis*, Research Paper 26, (Kingston: Institute of Intergovernmental Relations, 1989).
13. For this conference, other presentations will discuss the constitutional issues in greater detail. A good general overview of the constitutional law issues related to Canadian external trade policy was provided for the Royal Commission on the Economic Union and Development Prospects for Canada in 1985 (Hereafter referred to as Macdonald Commission); see F. Scott Fairley, "Constitutional Aspects of External Trade Policy" in M. Krasnick (ed.), *Case Studies in the*

Division of Powers, Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada, vol. 62 (Toronto: University of Toronto Press, 1986), pp. 1-51.

14. All references to constitutional section numbers refer to the *Constitution Act, 1867*, as amended. See Fairley, "Constitutional Aspects," pp. 2-18.

15. *A.G. Can. v. A.G. Ont. (Labour Conventions)*, [1937] A.C. 326 (P.C.); for an example of contemporary commentary see F.R. Scott, "The Consequences of the Privy Council Decisions" (1937), 15 *Canadian Bar Review*, 485. For an overview from a political scientist see Alan C. Cairns, "The Judicial Committee and Its Critics," reprinted in D. Williams (ed.), *Constitution, Government and Society in Canada: Selected Essays by Alan C. Cairns* (Toronto: McClelland and Stewart, 1988), pp. 43-85.

16. The discussion in this paragraph is based on Fairley; Bernier and Binette, *Les provinces canadiennes et le commerce international*, chap. 5; and John Whyte "Federal Powers over the Economy: Finding New Jurisdictional Room," *Canadian Business Law Journal*, vol. 13, 1987.

17. *Constitution Act, 1867.*

18. John Quinn, "Federalism and Foreign Economic Relations," *Canada-United States Law Journal*, vol. 10, 1985, pp. 197-219.

19. Fairley discusses this concept of "balance" in "Constitutional aspects of External Trade Policy," pp. 1-2. He cites two articles by W.R. Lederman as insightful in this regard: "The Balanced Interpretation of the Federal Distribution of Legislative Powers in Canada" (1965), and "Unity and Diversity in Canadian Federalism: Ideals and Methods of Moderation" (1975). Both are reprinted in W.R. Lederman, *Continuing Canadian Constitutional Dilemmas* (Toronto: Butterworths, 1981).

20. On the legacy of the National Policy see G. Stevenson, *Unfulfilled Union: Canadian Federalism and National Unity*, (3d ed.) (Toronto: Gage, 1989) pp. 75-81; see also articles by Paul Phillips, David E. Smith and T.W. Acheson in D.J. Bercuson (ed.), *Canada and the Burden of Unity* (Toronto: Macmillan, 1977); P.M. Leslie, *Federal State, National Economy* (Toronto: University of Toronto Press, 1987) pp. 4-7; and *Report of the Royal Commission on the Economic Union and Development Prospects for Canada*, vol. 1, (Ottawa: Minister of Supply and Services, Canada, 1985) pp. 213-24.

21. See Economic Council of Canada, *Looking Outward: A New Trade Strategy for Canada* (Ottawa: Information Canada, 1974) esp. chap. 4, pp. 39-46; a good summary of the economic literature and an effective presentation of the evidence may be found in Shearer, "Regionalism and International Trade Policy."

22. See Lazar, *The New Protectionism*.

23. For a discussion of the rise of provincial governments as primary representatives of regional interests see Smiley, *The Federal Condition*, pp. 85-87; see also Gordon Robertson "The Role of Interministerial Conferences in the Decision-Making Process," in R. Simeon (ed.), *Confrontation and Collaboration Intergovernmental Relations in Canada Today* (Toronto: Institute of Public Administration of Canada, 1979), pp. 78-88.

24. See D.V. Smiley and R.L. Watts, *Intrastate Federalism in Canada*, Research Studies of the Royal Commission on the Economic Union and Development

Prospects for Canada, vol. 39, (Toronto: University of Toronto Press, 1985), esp. chap. 4.

25. For a further discussion see R. Simeon and G. Robertson in R. Simeon (ed.), *Confrontation and Collaboration*.
26. Gilbert R. Winham, "Bureaucratic politics and Canadian trade negotiation," *International Journal*, vol. 34, Winter, 1978-79, pp. 64-89. See also his article "The prenegotiation phase of the Uruguay Round," *International Journal*, vol. 44, no. 2, Spring, 1989, pp. 280-303.
27. See, for example, Sean Riley, "Federalism and Canadian Trade Policy: The Early Days of the Mulroney Government" in T. Keating and D. Munton (ed.), *The Provinces and Canadian Foreign Policy*, Proceedings of a conference , University of Alberta, March 1985; pp. 45-46; see also Michael Hart, *Canadian Economic Development and the International Trading System: Constraints and Opportunities*, Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada, vol. 53, (Toronto: University of Toronto Press, 1985) pp.73-77.
28. This conclusion is supported by interviews undertaken by Donald Padget in preparation for a master's thesis in the Department of Political Studies at Queen's University (in progress, 1990), entitled "Canadian Federal-Provincial Relations Regarding the Negotiation and Implementation of the Canada-United States Free Trade Agreement."
29. GATT, *Text of the General Agreement*, Geneva, 1986
30. Bernier and Binette, *Les provinces canadiennes*, pp. 107-8; Fairley, "Constitutional Aspects," pp. 25-29.
31. Winham "Bureaucratic Politics," p. 73.
32. For a complete overview of the Tokyo Round negotiations and its implications from a Canadian perspective, see Frank Stone, *Canada, the GATT and the International Trade System*, chap.15.
33. The analysis of the process of federal-provincial relations in the Tokyo Round is drawn mainly from Winham, "Bureaucratic Politics." For reinforcing comments see Hart, *Canadian Economic Development*; Riley, "Federalism", and *Report*, vol. 1, op.cit., pp. 368-73.
34. Winham, "Bureaucratic Politics," p. 76.
35. Ibid., pp. 79-82.
36. The issue of the disparity in the resources which individual provinces have to devote to this task is discussed in the last part of this paper.
37. For a general discussion of this broader debate see Douglas M. Brown and Julia Eastman, with Ian Robinson, *The Limits of Consultation: A Debate Among Ottawa, the Provinces and the Private Sector on an Industrial Strategy* (Ottawa: Science Council of Canada and Institute of Intergovernmental Relations, 1981).
38. For discussion of "federal state clauses" see Bernier and Binette, *Les provinces canadiennes*, pp.129-34.
39. *Report*, vol.III, p.153; see also vol. I, pp. 368-73.
40. The following discussion is based on the author's article "The Federal-Provincial Consultation Process," in P.M. Leslie and R.L. Watts (eds.), *Canada: The State of the Federation 1987-88* (Kingston: Institute of Intergovernmental Relations, 1988), pp. 77-93; supplemented by research by Donald Padget.

41. See Brown, ibid., p.82. Based on correspondence from Premier Getty, to the Prime Minister in March 1986.
42. This is the view of many of the participants, including key federal oficials. See Brown, ibid., and interviews conducted by Donald Padget.
43. Brown, ibid., pp.90-91; and research in progress by Padget.
44. The Ontario government's position is set forth in Attorney General for Ontario, *The Impact of the Canada-U.S. Trade Agreement: A Legal Analysis*, May 1988; see also an article by Anonymous, "Canada-U.S. Free Trade: The Constitutional Issues" in Leslie and Watts, *Canada: The State of the Federation, 1987-88*, pp. 39-55; articles by Marilyn Pilkington, F. Scott Fairley, Dale Gibson and Ivan Bernier in Marc Gold and David Leyton-Brown (eds.), *Trade-Offs on Free Trade: The Canada-U.S. Free Trade Agreement*, (Toronto: Carswell, 1988) pp. 89-129.
45. For commentary on this point see Anonymous, ibid., pp. 51-53; Bernier and Binette, *Les provinces canadiennes*, pp.190-95; and M. Pilkington in Gold (ed.), ibid., pp.96-97.
46. See Anonymous, "Canada-U.S. Free Trade," pp. 44-47.
47. Draft Bill 62, *Free Trade Implementation Act* of the Alberta Legislature was tabled in June 1988, but died with the end of the legislative session. On 15 June 1988, the Government of Quebec issued decree No. 944-88, by order-in-council, "Regarding the Free Trade Agreement between Canada and the United States."
48. The four legislative enactments were: The Independent Health Facilities Act; an amendment to the Power Corporation Act; an amendment to the Wine Content Act; and an amendment to the Water Transfer Control Act.
49. Ontario agreed to phase out discriminatory pricing practices on U.S. wines as stipulated in the FTA, as part of a total package of measures that included adjustment assistance for the wine industry. See part three of this paper.
50. The following discussion is drawn in part from the author's article "Canadian Federalism and Trade Policy: The Uruguay Round Agenda," in R.L. Watts and D.M. Brown (eds.), *Canada: The State of the Federation 1989* (Kingston: Institute of Intergovernmental Relations, 1989) pp. 211-35.
51. See ibid., pp. 215-19 for a more complete discussion.
52. *Western Trade Objectives: Report of the Western Ministers Responsible for Multilateral Trade Negotiations to the Western Premiers Conference* at Camrose, Alberta, 27-28 June 1989.
53. These developments are discussed in Michael B. Percy and Christian Yoder, *The Softwood Lumber Dispute and Canada-U.S. Trade in Natural Resources* (Ottawa: Institute for Research on Public Policy, 1987), chap. 5. For a good discussion of the changing nature of the United States' trade remedy process in 1986-87, see Shirley Coffield, "United States-Canada Natural Resources Trade: Sources of Conflict/Prospects for Agreement" in J. Owen Saunders (ed.), *Trading Canada's Natural Resources* (Toronto: Carswell, 1987), pp. 121-53.
54. See Fairley, "Constitutional Aspects of External Trade Policy," pp. 15-18.; Percy and Yoder, ibid., pp. 81-85.
55. Fairley, ibid.
56. For example, David Leyton-Brown, *Weathering the Storm: Canadian-U.S. Relations, 1980-83* (Toronto: Canadian-American Committee, C.D. Howe Institute, 1985), p. 55.

57. For a discussion of the *Softwood Lumber Products Export Charge Act*, see Constance Hunt, "Jurisdiction over Natural Resources Trade in Canada," in Saunders (ed.) *Trading Canada's Natural Resources*, pp. 253-79, especially, pp. 264-68.
58. See Peter Foster, "Stumped," *Saturday Night*, vol. 102, no. 7, July 1987.
59. For a discussion on these points see Percy and Yoder, *The Softwood Lumber Dispute*, pp. 126-30; Foster, "Stumped," Hunt, "Jurisdiction over Natural Resources," and Richard Simeon, "Federalism and Free Trade" in P.M. Leslie (ed.), *Canada: The State of the Federation 1986* (Kingston: Institute of Intergovernmental Relations, 1987), pp. 189-212.
60. See Hunt, ibid.
61. Ibid.
62. Hart, *Canadian Economic Development*, p.75.
63. For a brief summary of the issues in the dispute see Fairley, "Constitutional Aspects," pp.25-29; Bernier and Binette, *Les provinces canadiennes*, 129-33.
64. See GATT Secretariat, Panel on Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies, Report of the Panel, 12 October 1987, pp. 7-43; on article XXIV(12) see pp.26-37.
65. Agreement Between Canada and the European Community Concerning Trade and Commerce in Alcoholic Beverages, 20 Dec. 1988.
66. Fairley, "Constitutional Aspects," p.29.
67. Bernier and Binette, *Les provinces canadiennes*, p. 138.
68. K.C. Wheare, *Federal Government* (London: Oxford University Press, [1946] 1963), p. 186.
69. Ibid., pp. 172-73;
70. Ibid., pp. 182-83.
71. For a full discussion see Jock Finlayson, "Canada, Congress and U.S. Foreign Economic Policy," in Denis Stairs and Gilbert Winham (eds.), *The Politics of Canada's Economic Relations with the United States*, Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada, vol. 29 (Toronto: University of Toronto Press, 1985) pp.127-77; and I.M. Destler, *Making Foreign Economic Policy* (Washington: Brookings Institution, 1980).
72. For a useful account see Glenn Tobin, "US-Canada Free Trade Negotiations," Case study C16, Kennedy School of Government Case Program (Cambridge, MA: Harvard College, 1987).
73. For an analysis of the role of the states in international affairs that compares them with Canadian provinces, see Earl Fry, "The Impact of Federalism on the Development of International Economic Relations: Lessons from the United States and Canada," *Australian Outlook: The Journal of International Affairs*, vol. 43, April 1989, pp. 16-35; and John Kincaid, "Implications of Constituent Diplomacy for the European Communities," paper delivered at a conference "Federal-Type Solutions and their Implications for European Integration," Bruges, Belgium, 26-29 October 1989.
74. See for example, National Governors' Association, *Policy Positions, 1989-90*, pp. 293-305.
75. Based on interviews conducted with American officials by Donald Padget.

76. Kincaid, "Implications of Constituent Diplomacy," pp. 14-15.
77. Personal communication with Canadian trade officials.
78. For a comparison of the Australian and Canadian situations see Wheare, *Federal Government*, pp. 174-80.
79. *Commonwealth of Australia v. State of Tasmania (Franklin River Dam)* 1983, 46. A.L.R., 625 (H.C.); for an analysis see Henry Burmester, "Federalism, the States and International Affairs — A Legal Perspective," in Brian Galligan (ed.), *Australian Federalism* (Melbourne: Longman, Cheshire, 1989), pp. 196-99.
80. Part C, "Principles and Procedures for Commonwealth-State consultation on treaties," adopted at the Premiers' Conference, June 1982, as subsequently endorsed by the Commonwealth in October 1983; printed as Appendix in Burmester, ibid., pp. 212-15.
81. See Watts, *Executive Federalism*.
82. See Burmester, "Federalism", pp. 208-9 and Appendix.
83. See Brian Hocking, "Regional governments and international affairs: foreign policy problem or deviant behaviour?" *International Journal*, vol.41, no.3, Summer 1986, pp. 499-502.
84. For an overview see Hans J. Michelmann, "Federalism and international relations in Canada and the Federal Republic of Germany," *International Journal*, vol. 41, no. 3, Summer 1986, pp. 539-71.
85. This arrangement is formalized in the "Lindau Agreement." See ibid., pp. 500-2.
86. See Klaus Otto Nass, "The Foreign and European Policy of the German Länder," *Publius*, vol. 19, no. 4, Fall 1989, pp. 165-84, especially at pp. 165-66. Also Michelmann, "Federalism and international relations"; these sources do not indicate whether Permanent Treaty Commission officials are present at foreign negotiations, but this seems unlikely.
87. Nass, ibid.
88. This issue is the subject of a paper by Wolfgang Renzsch, "Recent Attitudes of the German Länder Toward European Integration," paper prepared for conference "Federal-Type Solutions and their Implications for European Integration," Bruges, 26-28 October 1989.
89. For a discussion see Michael Hart, "The Future on the Table: The Continuing Negotiating Agenda under the Canada-United States Free Trade Agreement," in R. Dearden, M. Hart and D. Steger (eds.), *Living With Free Trade: Canada, The Free Trade Agreement and the GATT* (Ottawa: IRPP, 1989).
90. See R. Simeon, "Free Trade and Federalism," and his "Global Economy/Domestic Society: Competing Challenges to Governance in Canada," in K.L. Brownsey (ed.), *Canada-Japan: Policy Issues for the Future* (Halifax: IRPP, 1989).
91. Hart, *Canadian Economic Development*, p. 75.
92. This is a concept developed by Fritz Scharf with respect to a limited set of requirements under the Basic Law of the Federal Republic of Germany. However, the broader concept is worth applying. Martin Painter has done this in his unpublished paper, "Intergovernmentalism in Federal Systems: An Institutional Analysis," (1989).
93. For a discussion of the merits and drawbacks of "unilateralism," see Peter M. Leslie, *Federal State: National Economy* (Toronto: University of Toronto Press, 1987), chap. 5; Kenneth McRoberts, "Unilateralism, Bilateralism and Multi-

lateralism: Approaches to Canadian Federalism," in R. Simeon (ed.) *Intergovernmental Relations*, Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada, vol. 63 (Toronto: University of Toronto Press, 1985), pp. 71-129.

94. Painter, "Intergovernmentalism," p. 24.
95. See Fairley "Constitutional Aspects of External Trade Policy," pp. 30-31; Leslie, *Federal State*, Frederick Fletcher and Donald Wallace "Federal-Provincial Relations and the Making of Public Policy in Canada," in R. Simeon (ed.) *Division of Powers and Public Policy*, Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada, vol. 61 (Toronto: University of Toronto Press, 1985), esp. pp. 151-77; and J. Stefan Dupré, "Reflections on the Workability of Executive Federalism," in R. Simeon (ed.), *Intergovernmental Relations*, pp. 1-32.
96. See Macdonald Commission, *Report*, vol III, pp. 421, 467-8; see also pp. 151-56.
97. This option was proposed, among others, by the Canadian Bar Association in its 1978 report *Towards A New Canada*.
98. George J. Szablowski, "Treaty-Making Power in the Context of Canadian Politics: An Exploratory and Innovative Approach," in C. Beckton and A.W. MacKay (eds.), *Recurring Issues in Canadian Federalism*, Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada, vol. 57 (Toronto: University of Toronto Press, 1986), pp. 171-74.
99. See Fairley, "Constitutional Aspects" and Whyte, "Federal Powers," and the papers by Ivan Bernier and Robert Richards in this volume.
100. See John Whyte, "Issues in Federal-Provincial Co-operation," in J. Owen Saunders (ed.), *Managing Natural Resources in a Federal State* (Toronto: Carswell, 1988); for a full discussion of this topic, see Steven A. Kennett, *Interjurisdictional Water Resource Management in Canada: A Constitutional Analysis* (M.M.L. Thesis, Queen's University, 1989); chap. 3, part V; pp. 129-64.
101. For a discussion of the merits of departing from uniformity and unanimity in decision-making see Painter, "Intergovernmentalism", and McRoberts, "Unilateralism."

An Alberta Perspective — Panel Remarks

Wayne Clifford

Let me be the first to congratulate Doug Brown on his paper. I think it's an excellent contribution on the role of the provinces in Canada's international trade policy. I think as practitioners many of us can probably look at it and see that, while there's nothing really new there, it's the first time it has all been assembled together in one document. I think that's a very useful contribution for all of us. It reminds us of some of the things that happened many years ago. I guess I'm particularly pleased with the paper too because it incorporates a number of ideas that Alberta has presented in the past in a number of position papers to the federal government. I think the paper raises some very important questions and they are difficult questions. It is going to be difficult to come up with solutions that meet everybody's needs, but I think the fact that we are now engaged in discussions with the federal government on these issues is a good sign. And we've certainly seen significant progress in the last five or six years in terms of how the federal government is involving the provinces in trade negotiations and trade disputes.

One point that came up in the paper and which frequently comes up, particularly in newspaper articles, is the whole question of regional rivalries and the difficulties of making trade policy in Canada because of the differences of the economies of the regions. I look at Alberta's experience back in the 1970s, when that was a very valid comment. If you look at the Western Economic Opportunities Conference, which was held in 1973 in Calgary between the four western premiers and Prime Minister Trudeau, there were four major papers and four major topics. One of them was Trade and Tariffs and it was interesting that the word "tariffs" was in the paper because that was obviously the preoccupation of trade in the early 1970s. But what that reflected, and what that conference reflected was the historical western Canadian grievances against central Canada, against the "National Policy." This concern was reflected in the subsequent years in terms of Alberta's activities. Premier Lougheed visited Geneva a number of times, Alberta was very active in presenting position papers, and the four western provinces presented joint position papers to Ottawa. We very much saw this is terms of the west being for free trade and market liberalization, while central Canada was still tied to many protectionist tenets of the National Policy. So there was certainly regional rivalry then.

I think what I would say now is that, looking back over the last ten years, there has been an increasing realization by all provinces of the impact of changes in the world economy (interdependence, globalization) on provincial economies and the realization that provincial areas of jurisdiction fall increasingly within the scope of trade negotiations, which has moved into the many new areas being discussed in the Uruguay Round, as well as agriculture and subsidies. What all of this has brought us to realize is that we have to work together, and that we need the consultation procedures that have been set up by the federal government with some urging from the provinces in the last six years, particularly during the Free Trade Agreement, and now with the Uruguay Round. These federal-provincial continuing committees of officials are very necessary and useful bodies. They allow us as provinces to sit down and talk among ourselves and with the federal government about these issues. We realize that while there are still some regional differences, there is a remarkable number of common views on how to deal with these questions as Canadians. In looking at the three questions posed at the end of your paper, Doug there are two of them in particular that I'm interested in addressing briefly. The question of consultation and the question of binding.

I think we have a consultation process in place now. It got underway in the free trade negotiations and I think that was a major milestone in consultation between the provinces and the federal government. We think it could go further, that the consultation could be deeper and broader, and that's one of the things we are working towards now in talks with the federal government. But what Alberta has been saying for a number of years is that we need to formalize the structures. There needs to be more predictability in how we do these things. If we look briefly at three trade disputes of the last few years, I think we see some signposts on how we might resolve this question of bringing the provinces more into the mainstream of Canadian trade policy formulation and also of binding the provinces to the commitments that Canada will have to undertake.

The Softwood Lumber dispute was an interesting example, and it contained very extensive provincial involvement. I think if we look at the final resolution of the dispute in all our provincial capitals, we all went through considerable debate about what the best course was going to be, and about whether we should have gone for a termination agreement. I think in the final analysis the MOU that was achieved was broadly supported by most provinces. In Alberta we looked at that particularly as a way of avoiding undue American intrusion into our jurisdiction. When you look at the amount of monitoring and verification that the Commerce Department undertakes on a countervail case, the MOU which the Canadian government undertook on behalf of the provinces was a preferable course. Provinces accepted an export tax in that case, but we accepted it because we were part of the process that achieved that arrangement. In the case of Alberta, we exchanged letters with the federal government at the end of that negotiation thereby formally setting out in an agreement the settlement, while very much maintaining that control over resource issues is a provincial matter.

A second trade dispute, which I think is a good indication of how we ought not to go, has been the Liquor Board dispute with the European Communities. The GATT Statement of Intent, which the provinces agreed to in 1979 was a very nebulous sort of concept. It was never really defined, nobody knew quite how binding it was. I think in our case, Alberta saw it as binding. I think if we look back now we can see that it perhaps didn't help Canada's overall image with our trading partners in that we were not able to live up to what our trading partners certainly saw as a commitment. So I think that's an indication that Canada needs to look at something that is more formalized and more binding.

A third trade dispute, which wasn't touched upon in the paper but which I think offers some very interesting indications of how we might go has been the Pork Countervail case, which was underway last year and is now in the appeal process under the bilateral panel set up under Chapter 19 of the Free Trade Agreement. We feel that the way that the provinces have worked with the federal government in both fighting the countervail and now in coordinating the appeals has been a very good example of how the provinces and federal government can work together. The provinces in question have lawyers in Washington fighting the case. The lawyers meet regularly with the federal lawyers and the federal people there to coordinate our strategy; and similarly here in Canada there have been extensive meetings at the officials level to coordinate the Canadian response. I think that's a model that we can look at as we try to formalize the federal-provincial arrangement in this area.

If we look at the question of how can we bind provinces we have a couple of ideas in Alberta that we think are worth looking at. Variations of these have been suggested in the past and are being considered now in other fora. First, our suggestion would be that we look at a formal federal-provincial agreement that sets out how provinces should be involved in negotiation and implementation of an agreement. That's very easy to say, but it's going to be very difficult to work out the details, because every word that we start talking about in that context takes on different meanings for different parties. But we think it's vital for Canada that we have more predictability, that our trading partners are able to look and say that Canada has got its house in order internally, and that they can rely on Canada to deliver on its promises. As I mentioned before, I don't think we were able to do that on the Liquor Board issue. So we feel that a formal federal-provincial agreement would resolve this dilemma for Canada. Second, and related to that, we would suggest that we look at the example of the Canada/U.S. Alaska Pipeline Treaty, where the provinces in question signed an annex to the agreement undertaking to allow certain things to happen. This did not present any legal problems for the federal government at the time in the mid-1970s, and we think that's an example that we could use, in our international trading arrangements to provide more reassurance to our trading partners that the provinces are serious about their undertakings. The third element of a more formalized structure we would suggest is that where provinces have signed onto an annex and have agreed to perform certain acts in terms of implementing an agreement, then those provinces should pass implementing legislation covering those particular areas within their jurisdiction. This would include areas ranging from services, to agriculture, to subsidies, to government procurement.

In summary I'd like to point out that when we propose these sorts of more formalized structures we're very conscious of the need for Canada to speak with one voice. We think that's essential. But Canada has to look at this as more of a team effort, since the provinces are involved in so many of the areas in international trade negotiations and that involvement is only going to increase with the global interdependence that we see increasingly. So, it's vital that Canada speak with one voice, but we have to make sure that that voice is unified within Canada. That's doubly important given the necessity for Canada of having international trade rules that we can live by in a world of economic giants like the United States and Europe. International rules of law are very important for a trading nation like Canada and they are important for the provinces. Hence, it is in our interest to bolster Canada's ability to live up to those rules, and thereby to further the role of law in international trade.

And finally in closing I'd like to say that we're very conscious of the significant strides that the federal government has made in the last six years in terms of involving the provinces in international trade. Out in Alberta we think more can be done, but we're very conscious of the significant progress we've made and we look forward to working with the federal government to get this tied down a little more clearly.

Une perspective québécoise: les commentaires d'un panéliste

Carl Grenier

Comme vous venez de le signaler, j'ai fait mon apprentissage en politique commerciale à Genève, avec les gens qui sont connus par la plupart d'entre vous, je pense surtout à des Canadiens comme Rodney Gray, Mel Clark et évidemment Germain Denis qui était ici ce matin, et sans oublier M. Warren, qui s'est joint à l'équipe après un certain temps. C'est avec ces gens-là que j'ai commencé à traiter des questions de politique commerciale. Maintenant, ma perspective est un peu (mais pas complètement) différente car c'est une perspective provinciale.

Laissez-moi d'abord m'associer à mon collègue Wayne Clifford pour féliciter Doug Brown de son travail. Je savais que Doug Brown travaillait sur cet article depuis un certain temps déjà et je trouve que c'est un résultat remarquable. Je précise tout de suite que je suis largement d'accord avec son étude, et avec la plupart des conclusions qu'il tire. Je ne pense pas cependant pouvoir endosser certaines hypothèses qu'il explore à la fin de son article, notamment quant à des changements constitutionnels qui seraient nécessaires pour améliorer le système. Et je pense que vous allez comprendre pourquoi après mes propos.

Il y a trois points en fait que j'aimerais faire ressortir ici. Deux d'entre eux sont contenus dans l'étude de Doug, un troisième n'y est pas vraiment, sauf par allusion, et deux autres points auxquels je voudrais ajouter des commentaires qui sont en fait contenus dans l'article.

Le premier point, c'est que l'intérêt des provinces pour les questions de politique commerciale a été provoqué par une évolution externe, c'est-à-dire l'évolution des négociations commerciales internationales. Je pense que c'est évident que si les provinces, avant les années 70, ne s'intéressaient peu ou pas aux négociations commerciales, c'était évidemment parce que les questions qui étaient discutées n'étaient pas du tout de leur ressort, mais pas du tout, comme les tarifs ou les restrictions quantitatives. Aussitôt qu'on a commencé les travaux préliminaires du Tokyo Round, les bâillons tarifaires ont été examinés, et on savait en 1973 que ça ferait l'objet de négociations. Je rappelle simplement pour mémoire que le Ministre de l'Industrie et du Commerce du Québec d'alors, M. Guy St-Pierre, avait demandé publiquement, environ 6 mois avant le début des négociations du Tokyo Round, une forme de participation ou de consultation des provinces à ces négociations.

Le deuxième point que j'aimerais amener ici, et je pense que c'est traité sous plusieurs aspects dans l'étude de Doug Brown, c'est que d'une façon qui est généralement consistante le gouvernement fédéral a répondu positivement à ces nouveaux besoins de liaison, de consultation, et j'irais même jusqu'à parler justement de participation qui avaient été crées par ces nouveaux ordres du jour par les négociations commerciales multilatérales. Çela été une évolution lente, je pense, adaptée aux besoins qui changeaient peut-être aussi eux-mêmes plutôt lentement, mais je pense qu'il faut souligner que la réponse générale du gouvernement fédéral a été positive. Les mécanismes qui sont évoqués de façon précise dans l'étude de M. Brown ont, je pense, entre autres, trois caractéristiques. D'abord, ils sont définis par le gouvernement fédéral. Les provinces ont souvent des suggestions très précises à faire à ce sujet-là, et on le voit aussi dans l'étude, mais éventuellement, la définition de ces mécanismes-là est faite par le gouvernement fédéral. Deuxième caractéristique qu'ils ont en commun: ils sont flexibles et ils sont capables d'évolution. Je pense qu'il faut regarder l'évolution du rôle du comité fédéral/provincial des sous-ministres qui a été créé en 1975 et qui a été actif jusqu'en 1985, donc dont l'action s'est prolongée bien au-delà de la fin des négociations du Tokyo Round en 1979. Troisième caractéristique, c'est que ces mécanismes-là sont peu ou pas formalisés. Il s'agit de mécanismes informels qui ne sont bien souvent même pas définis par une lettre ou un communiqué de presse. Il y a là effectivement une caractéristique sur laquelle je reviendrai.

Je pense aussi qu'il faut souligner le type d'évolution qu'on a connu depuis une dizaine, une quinzaine d'années. On peut remonter carrément jusqu'en 1975. Il y a eu un changement absolument remarquable pour quelqu'un qui a été associé à ces mécanismes-là depuis le début. D'abord, prenez simplement la documentation. Pendant les négociations du Tokyo Round, et ceux d'entre vous qui étaient impliqués pourront me corriger, il n'était à peu près jamais le cas qu'on ait accès à des documents de négociation. Je faisais le compte tantôt de façon informelle, avec François Gauthier, et depuis le début du nouveau mécanisme, le Comité sur les négociations commerciales multilatérales qui a été mis en place l'an dernier par le gouvernement fédéral, il y a quelque chose comme cinq mille pages de documentation qui ont été transmises aux provinces de la part du fédéral. Alors vous voyez la différence, et effectivement dans certains cas ça devient un problème de traiter toute cette information.

Une autre chose qui s'est améliorée, et il faut le souligner parce que c'était une plainte absolument constante au début de la période, c'était le retard dans les documents quand il y en avait et c'est le peu de temps qu'on avait pour faire des commentaires là-dessus. Cela a complètement changé et c'est rare maintenant que l'on ait ce genre de situation.

Le troisième point qui est important et à souligner, et qui n'est pas vraiment contenu dans l'étude de Doug, c'est celui-ci: vu la nature permanente ou quasi-permanente d'accords comme celui du libre-échange ou du GATT, évidemment, et vu aussi la fréquence des litiges, qui est assez constante dans le temps, je pense qu'il est assez clair qu'il est dans l'intérêt commun au Canada de formaliser ces mécanismes de participation et de consultation. Et ça, je le précise tout de suite pour qu'il n'y ait pas d'équivoque, sans qu'il y ait nécessité de modifier l'équilibre des pouvoirs en matière d'accords de commerce international, qui a fait l'objet de présentations ce matin et qui sans doute va faire l'objet d'autres présentations un peu plus tard. Sans qu'on ait besoin de modifier cet équilibre-là, il y a un besoin, selon moi, de formaliser ces mécanismes-là. D'abord, et cela a déjà été souligné, la nécessité d'avoir un front uni vis-à-vis les défis externes qui nous sont proposés. On a besoin alors de mécanismes permanents, et aussi le fait que l'on a besoin aussi de se protéger soi-même contre les changements inévitables dans le personnel, le personnel administratif, le personnel politique, le changement de gouvernement éventuellement. On a besoin de quelque chose de permanent comme mécanisme de consultation et de participation, pour justement se servir des accords qui ont eux aussi une caractéristique de permanence.

Evidemment, ça présente un certain problème. On a évoqué tantôt tous les efforts qui sont en cours pour formaliser les mécanismes qu'on a en place maintenant depuis presque cinq ans entre le fédéral et les provinces. Ça présente un certain nombre de difficultés, mais je pense que ces difficultés sont aplanissables. Ces difficultés se font particulièrement sentir dans le domaine de règlement des différends, où l'expérience des provinces est peut-être moins longue et moins intense que dans les négociations elles-mêmes.

Deux points finalement concernant des observations qui sont contenues dans l'article. Notamment, en page 10, l'auteur mentionne que la concertation croissante entre le gouvernement fédéral et les provinces se fait au détriment du secteur privé. Moi je pense au contraire que ce n'est pas le cas. Je pense qu'il y a eu une croissance du niveau de consultation et de concertation entre le gouvernement fédéral et le secteur privé qui pourrait se comparer à ce qui est intervenu entre le gouvernement fédéral et les provinces. Et là je puise surtout dans mon expérience personnelle. Pendant le Tokyo Round il y avait une consultation très intense aussi avec le secteur privé, si on en juge simplement par la fréquence de visites que l'on recevait à Genève et pour lesquelles j'avais malheureusement la responsabilité administrative. Alors il n'y a pas de doute dans mon esprit qu'il y avait déjà une concertation très active avec le secteur privé, comme par exemple, plus récemment, lors de la négociation de l'Accord de Libre-échange. On a eu la création des SAGITs ("Sector Advisory Groups on International Trade") et de l'ITAC ("International Trade Advisory Committee"), dont la création s'est prolongée après la négociation elle-même. Dans le cas du bois d'oeuvre, parce que ça c'est un exemple que l'on voit à la page 30, exemple où l'implication des provinces l'a probablement emporté sur l'industrie elle-même à la fin, là je pense qu'il faut carrément souligner qu'il s'agit d'un cas bien particulier. Non seulement c'était une mesure provinciale qui était en cause, mais les provinces possèdent littéralement les ressources qui étaient en cause dans cette dispute-là. Il est alors normal qu'il y ait une consultation un peu plus étroite avec les provinces.

Deuxième point qui est évoqué par Doug Brown dans son étude qui à mon sens est absolument capitale, c'est ce qu'il appelle la routinisation des processus de consultation, et j'ajouterais aussi de participation, à la suite de M. Mulroney lui-même entre le fédéral et les provinces. Je pense que ça c'est absolument crucial. D'abord parce que, ces dernières années, il y a eu un développement de l'expertise des provinces et souvent cela s'est fait par le recrutement d'anciens négociateurs fédéraux, d'anciens hauts fonctionnaires fédéraux. Pendant les négociations du libre échange il y avait au moins trois provinces qui bénéficiaient de ce type d'expertise et certaines d'entre elles continuent d'en bénéficier. Entretemps je pense qu'il faut aussi souligner que le fédéral bénéficie d'un examen critique de ses positions avant qu'elles ne soient soumises à l'épreuve des négociations, ou qu'elles soient avancées sur l'échiquier international de négociations. Et là je pense que tous ceux qui ont eu à travailler avec les négociateurs de la Communauté économique européenne vont être d'accord pour dire que le processus interne qu'ils ont et qui n'est pas du tout comparable, enfin qui est beaucoup plus avancé que celui qu'on a au Canada, avec les états-membres, leur permet d'avoir des positions beaucoup mieux étayées. Donc ça devrait être un bénéfice qui se manifeste aussi pour nous.

Un point qui est aussi à souligner par Doug dans son étude, c'est l'inégalité des ressources humaines que les provinces ont à consacrer aux questions de politique commerciale tant pour les négociations économiques que pour le règlement des litiges. Je pense que ce n'est pas vraiment un problème véritable. Pourquoi? Pour deux raisons. D'une part si c'est une province qui a moins de ressources à consacrer, il faut dire au départ que c'est parce que les provinces ont des intérêts un peu moins étendues à défendre. Et je pense qu'en gros les provinces vont mettre les ressources qu'il faut pour défendre leurs intérêts. Voilà pour une première observation. Deuxièmement, je pense qu'à cause du mécanisme multilatéral de consultation qui s'est établi avec les provinces et entre le fédéral et les provinces, à ce moment-là ce n'est peut-être pas un problème aussi gros qu'on pourrait le penser parce que toutes les provinces bénéficient des expertises de chacune. C'est important.

Voilà, c'étaient les observations que j'avais à exprimer. En conclusion, je veux dire qu'il est extrêmement important, pour les raisons qui ont déjà été mentionnées et sur lesquelles je ne veux pas revenir, que ces mécanismes-là soient maintenus et si possible formalisés, parce qu'effectivement le reste du monde continue de tourner tandis qu'on s'applique à régler nos problèmes internes. Mais on n'a pas le loisir, nous, de leur dire: "Bon, écoutez, Meech Lake s'en vient, on va tout régler ça." La négociation va être terminée depuis longtemps. Merci bien.

The U.S. Perspective — Panel Remarks

Robert Herzstein

I would like to give a couple of comments based on my personal experience with the lumber case. Then, I will discuss an issue that I was requested to address — what are the challenges that Canada is likely to encounter as a result of the future behaviour of the U.S. government in the trade-policy arena. And third, I'll give a few very brief comments on the functioning of the U.S. constitutional system and the federal-state relationship in connection with trade policy. Most of you are reasonably familiar with our system, so I won't describe it in any systematic way, but simply give a few highlights as they occurred to me while reading the excellent paper by Douglas Brown. I too thought it was an eye opener and something that I'm going to be passing around among a number of American friends.

First, as to the lumber case I'm prompted by what some of the earlier speakers said to make a couple of comments. Looking at it from the point of view of a U.S. lawyer, who was very much involved in the case on behalf of the Canadian interests, it is true that when it came time to reach a resolution there was a tremendous amount of constructive discussion among the provinces. I think it's important to note, however (and this is certainly not news as a lot of this was discussed at the time), that the overall Canadian interest was not well-served by the highly pluralistic nature of the Canadian system during the time the case was underway.

There were public statements made by Canadian provincial officials that were sensible from their own particular perspectives, but did not make sense from the point of view of the Canadian position on the case. Provincial stumpage programs were effectively designed and were functioning to recover the full value of the trees harvested for lumber by the Canadian industry. The premier of British Columbia was reported in the Canadian newspapers as calling for a study of the question of whether the stumpage in British Columbia was high enough to recover the full value of the lumber. And, of course, the U.S. industry and the U.S. Consul General in Vancouver and others had their eyes well tuned to those interests. More generally, what the U.S. industry found was that it could influence the resolution of the Canadian side by playing the political forces in Canada. Reports of internal Canadian debates were being immediately transmitted to Washington and used in a way that influenced the decision-making process there.

I think that it's probably an inevitable part of the federal system, and I'm not sure there's any way of avoiding that kind of untidiness. We have certainly the same kinds of problems in our federal system. We see every day examples of Japanese and other foreign negotiators taking advantage either of our state/federal distinction or more commonly taking advantage of the widespread distribution of power between the executive branch and legislature and among the different government agencies. I think that many of our federal systems have that problem. It's an institutional one, but it's very real and that's why I have spent a few minutes on it.

Let me now turn to the question of the challenges that the Canadian governments are likely to encounter in the near future as a result of U.S. trade activities, and trade-policy programs. I think the best way to approach this is to start with a description of the traditional approach to trade policy and then indicate what is going to be coming in the future. As you well know, since 1947 beginning with the launching of the GATT system and the postwar trading order, the U.S. dogma on international economic policy has been that we will try to create a global system by reducing tariff subsidies and other trade distortions at the border through trade negotiations. To this system are combined our efforts with domestic laws that protect American industries against unfair practices resulting from dumping by foreign companies or subsidies by foreign governments. We also have an opportunity for industry to get temporary protection under the so-called "escape clause," section 201 of our trade law, temporary protection against surges of imports as a result of the lower tariff barriers that had been negotiated. So basically the American government has been telling its industry, "give us your support and we will go out and create a world market and at the same time will protect you from the unfair practices that might give you a disadvantage in that marketplace." As a whole, this basic doctrine is a bit old-fashioned now. What we have found is that the trade negotiations have moved far from border measures — tariffs and subsidies — into internal measures, legal regimes (often called nontariff barriers or nontariff distortions of trade), and we find that the current Uruguay Round is engaged primarily with negotiation on the harmonization or the creation of new neutral disciplines for the conduct of service industries investment and so forth. And similarly the system of protection against unfair practices has evolved under use, with the result that we have protection against unfair practices being often politically determined rather than legally determined. The lumber case, indeed, might be a good example of that. We have the grey area measures in steel, cars, and other areas where a system of protection is erected even though it cannot be justified under that traditional structure.

We are now seeing, in my view, a new stage in U.S. trade policy. In setting its priorities for trade negotiations, the U.S. government will be looking not so much at government measures but at structures that exist in foreign economies that affect the opportunities of American businesses to do business in other countries. The so-called structural impediments initiative that's going on with Japan right now arises from the feeling that even when you eliminate government measures, especially border measures, tariffs and subsidies, that everyone thought were the only impediments to trade, you still can't do business. Why can't you do business? Well, each country has evolved its own set of industrial structures, its own set of habits, its own set of government-industry relationships and in the case of Japan, quite dramatically, these become meaningful barriers to the opportunity to do business. American businessmen and European businessmen, and I suppose, Canadian businessmen come back from their efforts to deal in Japan and say, "I just can't make a sale because Toyota has surrounded itself with a group of companies literally within a mile or two from whom it has been buying its parts for years and there's cross-ownership and a high degree of loyalty and they're just not interested in dealing with an outsider." Or, they cannot sell their semiconductors because Hitachi makes both computers and semiconductors and obviously prefers its own supplies. Or, for example, Cray Research complains that it's not willing to trust Japanese microprocessor suppliers because the Japanese microprocessor suppliers also make, or attempt to make super computers to compete with Mr. Cray. So, it's these differences in industrial structure and in habits of business behaviour that are becoming the primary concerns of global businessmen at this point. Now the structural impediment initiative designed to deal with such concerns is proving to be extremely difficult, it's right in midstream at the moment. Large parts of it, I think, are going to be unsuccessful. If it is successful, the results will show up only over an extended period of time. But I think that is going to be the wave of the future.

A more concrete expression of that same concern shows up in so-called Super 301 provisions in the U.S. law. Starting back in the early '80s, Senator Danforth most prominently along with other members of Congress, started expressing their concern about this problem of structural barriers in foreign markets. You may recall that Danforth introduced a reciprocity bill that was results-oriented and provided that where the U.S. industry did not have equivalent market access in any industry sector in a foreign market to the extent of access of a foreign country to the United States market, then the Secretary of Commerce would be required to retaliate against that country. He was talked out of that provision on the grounds that it was eminently unworkable and troublesome and what he did instead was to establish the National Trade Estimates (NTE) Procedure under which a United States Trade Representative (USTR) was required to give a report each year on the conditions of access to foreign markets. His thought, and the thought of many, was that the publication of these trade estimates would do two things. One, it would discourage those practices in foreign countries; and two, it would put the U.S. authorities in a position where they had to take some kind of action either through negotiation or through the Unfair Trade Practice Laws, to go after those practices. The fact is that NTE got published every year, there was little press notice and it was forgotten. So the next step was a tightening of the ratchet by Congress in Super 301, which says that, as you know, the USTR is required to take a look at that net NTE when it comes out and identify the foreign practices that are most egregious and have the greatest impact on market access opportunities. The U.S. administration would be required to undertake negotiations and if the negotiations are not successful within a specified period of time, to take retaliatory measures against the foreign country in order to pry them loose. And, as you know, there's a whole series of Super 301 warnings and designations in place now. Another series is due to come out soon.

This is another version of the SII, a more concrete version. The SII, the Structural Impediments Initiative, is aimed at more underlying, long-term factors. The National Trade Estimate Super 301 approach is aimed at the more evident and immediate trade barriers but there is a threat now from Senator Baucus to meld the two. He has said that if the SII is not successful he will introduce legislation to add the topics being discussed in the SII with Japan to the items that are actionable under Section 301. The USTR would then be forced, presumably, to retaliate against Japan for failing to take action on some of the items that it has been trying to negotiate under the SII. There's a great fallacy in that because a lot of the SII items are not by any means issues of unfairness, they are simply structural differences that have evolved in the foreign country that make trade between it and the United States and other western countries difficult, and we all have our structural differences. I think that one of the things that's becoming evident in the globalization of the economy is that anytime a businessman encounters a condition different in a foreign country from what he's used to in the United States, he finds it either an advantage or a disadvantage, and the difference always is going to show up that way. It may be important, it may not be, but it doesn't mean that there's unfairness. It does mean that there's an awful lot of work for trade negotiators to do. In federal systems it means that those trade negotiations will be very complex indeed.

What does all of this mean for Canada specifically? I think that because of the Free Trade Agreement this National Trade Estimate Super 301 SII approach of trying to iron out significant structural differences between the two economies will take a different form. Those issues will tend to be raised either through the consultation process under Chapter 18 or otherwise, and will get worked out that way. But I think you will see that the U.S. will be raising issues of this structural nature in the coming years. Since a lot of these issues are structures that exist and are created at the provincial government level, the challenge to the Canadian federal decision-making process will be all the greater, and I think the future for those trade-policy officials who are going to work for the provincial government is a very good one indeed.

Finally, there are the negotiations under Chapter 19 of the Free Trade Agreement of the working group to achieve an agreement on the elimination of subsidies and the use of countervailing duty measures between the U.S. and Canada. This will be certainly be another place where these structural issues get raised. Will that working group go forward? It hasn't done anything yet as you know, as it is really biding its time until the subsidy negotiations in the Uruguay Round are finished. The FTA requires the two governments to make progress on this topic in a relatively few years, however, and there will be a certain pressure on both sides to go forward. My suggestion is that it will be found to be in the interests of both countries to go forward. I think the U.S. has a terrible problem with competition among the state governments to attract investment. It's a very costly competition involving heavy subsidies. It's a sort of "beggar thy neighbour" kind of policy, of which everyone would love to be relieved. We would love to see you Canadians cause us to have to give that up and maybe we could do you some favours by arguing to change some of your unproductive policies in the process. That's another place where the sort of structural approach to trade negotiations will be quite active.

Moving to a somewhat different subject and that is this question of federal versus state authority in the making and implementation of trade policy. We, of course, have a system very different from that described in Mr. Brown's paper. As we face globalization of the economy, we have resolved most of the problems of forming a national economy, but I'm not sure the same can be said of Canada. We're farther along in terms of dealing with our states. The foundation of federal power lies in two clauses of the Constitution; one is the commerce clause, which states that it is Congress that has the authority to make rules and regulations relating to commerce between the states and foreign nations and Indian tribes. I've then heard the comment that when it comes to Canada, Americans aren't sure whether Canada is a state, a foreign nation, or an Indian tribe. But anyway, it falls under that clause somewhere. And this clause has been interpreted by the Supreme Court to give a preemptive power to the federal government to create an exclusive federal authority to deal with matters of both interstate and international commerce. There're still lots of areas, such as antitrust regulations, where Congress has made it clear that federal authority is to be exercised on a concurrent but not exclusive basis, so that all the states have antitrust laws as well as the federal government, but when the federal government needs to preempt, it has the authority to do so.

The other key provision in the Constitution is, of course, the treaty making power combined with the supremacy clause. The Constitution provides that treaties can be made by the president and ratified by the Senate. Another clause says that treaties as well as certain other forms of law are the supreme of the land and preempt state law. So when a trade agreement is made Congress has the power to implement it in a way that simply brings the states into line. It doesn't always do so. Sometimes it leaves lots of room for state action and indeed the agreements themselves, such as the government procurement code and the standards code and certain others, leave lots of room for the states to do their own thing, sometimes calling on the federal government to try to discipline them or bring them into line in one way or another. That's not through lack of federal authority. The regional and industrial interests affected by trade negotiations, as Mr. Brown has mentioned, are expressed through the Congress rather than through the state governments. Our equivalent to your split between provincial and federal authority is the split between the two branches of government, the legislature and the executive. To the extent that we have severe problems in getting decisions made and in handling them in a way that appears coherent to outsiders, those problems arise from the separation between legislative and executive power.

Having described our legal structure in that way, I'll make a few comments just to contrast the American system with the Canadian system as described in Mr. Brown's paper.

1. Rarely do state governors ever come to Washington. They feel sort of outclassed and lonely and out of place in Washington. It's not their turf. Once in a while one will come, but he's rarely noticed. There might well be a foreign visitor from an entity that is much smaller than the state governor's own entity but the foreign visitor will get an awful lot more attention.
2. Our state governments don't have ministers of international affairs and they don't have ministers of international trade. People would think that very strange indeed. U.S. state officials, for the most part, would not understand GATT or trade-policy issues with sufficient sophistication to be helpful in the policy-making process. On other issues of direct interest to the states, the states do lobby in Washington both with the executive branch and in Congress, but they lobby in much the same

way as other interests. They either have an office with lobbyists in it or they hire lobbyists to work for them, or they send a delegation of businessmen and voters and public figures to Washington to visit Congress.

3. The U.S. has no equivalent to the First Ministers' Meetings and the concerns of the Canadian provincial governments about the issues in the Uruguay Round such as described in Mr. Brown's paper are, for the most part, simply not concerns of the states. Finally I'd say that the U.S. has not had a trade dispute such as a lumber case or liquor case in which compliance by the states with an international obligation was a significant issue. Nor has it had a trade negotiation involving a major concession that the states would have to implement.

These are a couple of broad generalizations, which some experts like Bill Diebold and others might be able to correct me on, but I think in general that conveys the broad differences between our systems.

International Trade and the Management of Federal-Provincial Relations

David Barrows and Gordon Jansen

Federal-provincial relations have always been important, but in the area of trade, the relationship is rapidly deepening. As we enter the 1990s, international, and indeed, domestic, trade relations are far more complex and politically sensitized than they have ever been in the past.

A significant requirement, as far as provinces are concerned, is that the federal-provincial structure evolve to reflect adequately this more complex international trading environment.

Canada's constitutional division of power between the provincial and federal levels of government was set in the nineteenth century.

At that time, although international trade was no less important to Canada's economy, it was a time when trade was considered somewhat as an adjunct to, rather than an integral part of, the domestic economy.

Indeed, when tariffs were the only trade barriers, provinces were not directly responsible for the conduct of international economic policy.

Since then the world and Canada have changed. International trade has expanded tremendously in the past several decades as have its composition and flow.

In volume terms, world trade has grown more than sixfold since 1950. World exports account for more than U.S.$3 trillion. Patterns have changed: the U.S. share of world exports has halved since 1950 from 22 percent to 11 percent; the

EC has emerged as the world's largest trading bloc; trade across the Pacific now exceeds transatlantic trade and it is expected that intra-Pacific trade will surpass transpacific trade in the early 1990s. The composition of trade has also changed: world trade in engineered and manufacturing products now accounts for over half of world trade while the share of agriculture and other crude materials has declined from over one-third to one-quarter. Trade in services is expanding: growth in commercial service exports outstripped the expansion of merchandise trade for most of the 1980s; the U.S. is the largest single service exporter, but collectively Western Europe accounts for over half of world service exports.

The impact of trade on domestic economies has increased in formerly insular economies such as the U.S.:

- as a share of GDP, U.S. imports have nearly tripled since 1960 from 3.2 percent to 9.4 percent;
- from another perspective, as a share of GDP, U.S. exports have about doubled since 1960 from 5 percent to nearly 10 percent.

Although the U.S. export share may seem small compared to Canada's 30 percent, the larger role of international trade in the U.S. economy has resulted in a significant increase in the politicization of trade relations, particularly in the U.S. Congress, and the resultant growth of U.S. nontariff barriers and contingency protectionism.

Trade barriers have also changed. As tariffs have declined over the past 40 years, nontariff barriers have expanded in their scope and impact. A number of these barriers can be attributed to the actions of subnational governments.

Finally, through the creation of strategic alliances and expanding foreign investments industry has globalized leading to new and more dynamic corporate structures.

As a consequence of all of the above trends, more of what we normally refer to as "domestic policy" has been internationalized through trade. The reverse is also apparent, that trade has been internalized into domestic policy. The concept of "trade policy" now has a much broader scope, politically and economically. As such, "trade policy" is now as much a provincial concern as it is a federal concern. This is not only the case for exports and market access issues; but also for the conduct of provincial policies.

A brief review of recent trade issues and disputes illustrates the contention that those that appear on the surface to be purely domestic and provincial in nature are now issues of international trade:

- A policy aimed at conservation and management of the west coast fishery resulted in the salmon and herring case.
- A government action to bridge a temporary problem resulting from new regulatory trucking legislation resulted in the 53-foot trailers case.

- Interprovincial trade barriers on beer have merged into an international trade dispute with the EC.
- Initiatives to manage better Ontario's health-care system have raised some concerns with Canada's trading partners.

In the Multilateral Trade Negotiations, as well as the Free Trade Agreement, the federal government is negotiating issues never before subject to significant multilateral disciplines and is consequently entering into a range of new obligations. The Uruguay Round has greatly expanded the scope of multilateral trade discussions. Investment, services, agriculture, intellectual property rights, all have significant areas of provincial interest, if not actual constitutional jurisdiction. In the FTA negotiations aim to replace countervailing duty and antidumping laws with a new bilateral regime.

Moreover, many of the proposals tabled in the negotiations could influence directly domestic policies that are not officially subject to negotiation. For example, the proposal for tradeable services tabled by developing countries includes provisions for the movement of workers across borders. This has a direct and immediate impact not only on immigration policies but also on such areas as domestic labour law.

The nature and scope of provincial obligations with respect to international trade agreements negotiated by the federal government remain contentious issues, given the evolution of the international trading system. GATT jurisprudence with respect to subnational obligations under GATT Article XXIV(12) is limited and not clearly settled. Nonetheless, federal states are required to take "reasonable measures" to ensure compliance to subnational jurisdictions. However, constitutional limitations on the powers of different federal governments can create an unbalanced result in the application of this provision. This issue of obligations is one element of the current Uruguay Round negotiations.

The trend is for more explicit requirements for provincial compliance to international trade agreements. Indeed, as we have seen in the FTA, Canada and the U.S. are obliged to take "all necessary measures" to ensure provincial and state compliance. Thus, in the context of an expanded scope of "trade negotiations," a significant role for provinces is clearly required.

It is a reasonable proposition that obligations to international agreements taken on by provinces would seem to require a corresponding degree of input into the negotiations and decision-making. This involvement would not only encourage provincial support in negotiations, but would greatly facilitate the subsequent implementation of such agreements by the provinces. These changes have been recognized by others in the globalization of obligations. One current example is the relationship of the EC member states, as well as their constituent parts, to the new Europe-wide implications of EC 1992 (not to mention an expanded Europe).

In Canada, there must also be a common understanding of what constitutes legitimate provincial interests and how provincial involvement in decision-making should occur. What constitutes legitimate provincial concerns? Initially, this involves defining the scope of provincial interests and would include issues that:

- are economic in nature and mainly direct in their implication;
- involve exports from, or imports to, the province of both goods and services; and
- are, in the view of the province concerned, important to the economy as a whole or to key participants in the economy.

The consultation process, or how provincial involvement will occur, should be defined as real input, that is, full participation in the decision-making process. Full participation requires input into the decision-making process at both the technical and political levels. This involves five key elements:

- problem identification;
- conceptualization of key issues;
- analysis of options;
- preparation of positions; and
- participation in the negotiation process (as observers, delegates and/or technical experts).

Prior to the formal commencement of Canada-U.S. FTA negotiations, the province of Ontario proposed a framework for technical and political joint decision-making. The model proposed a four-stage cooperative process:

- preparatory work: issues, concerns, objectives;
- approval of negotiating mandates;
- negotiations and preparation of draft agreements; and
- ratification and implementation.

This model could form the basis for managing the Canadian response to multilateral trade negotiations as well as the Chapter 19 Canada-U.S. subsidy and antidumping negotiations under the FTA.

In closing, provinces do not wish to fight over powers. However, there must be full recognition of the mutual interests of the federal and provincial governments in the conduct of international trade policy and in the administration of international trade agreements.

A British Columbia Perspective — Panel Remarks

Stuart Culbertson

I have been asked to present a brief look at the future of Federal-Provincial Policy Cooperation Coordination in a changing world economy. In focusing on this issue, I believe that there are three important objectives to keep in mind: (a) how to best use the international dimension of our economy to maximize economic development in Canada; (b) how to best deploy federal and provincial resources in strategically planning Canada's approaches to trade policy and trade promotion; and (c) how to diversify our trading relationship. In this context I would like to focus on our evolving relationships with the European Community and the Pacific Rim.

However, first, I would like to set the stage with a few relevant statistics on British Columbia's trade profile that distinguish it from the national trade profile and demonstrate how these objectives can be linked.

First of all, our 1989 trade figures show that exports of British Columbia origin to the Pacific Rim and to the United States are virtually equal — at roughly 41 percent each of our total exports. This is not a one-year anomaly. During the last ten years British Columbia's exports to the Pacific Rim have grown steadily from 30 to 40 percent of our total exports, while over the same time period our exports to the United States have declined at roughly the same pace from about 50 to 40 percent of our total exports. It is interesting to note that this decline occurred during a decade that was marked by an increase in Canada's dependency on the U.S. export market.

Second, I think an interesting fact is that throughout this ten-year period our exports to the European Community have remained relatively constant — at approximately 16 percent of our total exports. In 1989, British Columbia's exports to the European Community amounted to 2.7 billion dollars, which, in absolute dollar terms, almost matched the exports to the EC from Ontario and Quebec respectively.

I do not mean to minimize the importance of our trade with the United States in this analysis. Indeed, British Columbia strongly supported the Canada-U.S. Free Trade Agreement (FTA) from its outset as a means of securing and enhancing our access to what remains our single major export market. However, we hope that the FTA can continue to evolve in a way that consolidates our trading relationship with the United States. From this foundation, I believe that we should dedicate ourselves once again to the elusive task of diversifying Canada's national trade pattern. In the federal and provincial context, the critical question is how do we develop strategic plans to accomplish this and work together toward this goal?

One target area I would suggest is the "single market" European Community post-1992. Despite the complexities of the 1992 Initiative, it does provide a basic blueprint of what a single European market is going to look like, and it is against that blueprint that trade policies and trade strategies can be planned.

The prospects of an individual province or, indeed, Canada as a whole, significantly influencing the outcome of 1992 seem fairly remote, especially given that over half of the 279 measures deemed necessary to create the single market have now been adopted. Our challenge, as federal and provincial governments, is to ensure that policies and programs can be developed to ensure that Canadian companies are as well prepared as they can be to adjust to 1992's challenges and to take advantage of its market-opening opportunities. Some federal and provincial initiatives have been launched in this regard. External Affairs and International Trade have been co-hosting with provinces a series of conferences throughout Canada. While some sectoral impact assessment work has been done, more work is needed in terms of targeting information specifically to select industry groups and sub-groups. Given the regional dimension of our trade with the European Community, provinces are closer to these considerations and to the various sub-sectors that carry on that trade.

In British Columbia, we have recently created a private sector advisory committee chaired by our minister, the Honourable Elwood N. Veitch, on the 1992 Initiative to allow us to better target the sectors that will be affected by "1992" and to develop information for businesses in a manner that will be relevant to their day-to-day trade business.

From British Columbia's perspective, I think it is fair to say that the Asia-Pacific challenge is more complex and more daunting in its prospects but potentially much more rewarding. I do not think there is any need to recite here the astounding projections for Asia-Pacific growth in terms of trade, investment and influence on the world economy. In fact, we Canadians are particularly good at rolling out these numbers on the important evolving role of the Asia-Pacific region, but less skilled in articulating Canada's vision for our participation in the challenging Asia-Pacific future.

For British Columbia, this is now and will continue to be an important trade policy priority as we participate in managing economic relations in a federal state. Within Canada, British Columbia clearly has no geographic challengers to the title of Canada's Pacific Province. However, an analysis of Canada's Asia-Pacific trade profile shows that British Columbia has few, if any, commercial challengers to this title. From 1989 trade data, we find that products of British Columbia origin constitute 58 percent of Canada's total exports to Japan, 43 percent of our exports to Korea, 37 percent of our exports to Taiwan and 35 percent of our exports to Australia. British Columbia's share of Canada's trade with the Pacific Rim area is growing on all fronts as Canada's trade with these regions grows.

These figures underline British Columbia's special relationship with this region, and it is clearly in British Columbia's interest to develop our policies and our market intelligence in the Asia-Pacific region as much as we possibly can. We also need to attach more priority to influencing the federal government's planning on the Asia-Pacific agenda to assist us in meeting these objectives. Relative to our trade and our trade prospects with the Asia-Pacific region, I think it is fair to say that the resources that the federal government is dedicating to this goal are growing but still fall far short of what is, or will be, required to give this vision some reality.

On the marketing side, the Pacific 2000 Strategy unveiled last year by the federal government represents a solid start in the right direction. However, on the policy side, more work needs to be done — particularly in the area of federal-provincial consultation and coordination. There are two key developments that we can use to advance our goals in this area.

The first is the Multilateral Trade Negotiations (MTN). Canada's participation in the last seven rounds of the GATT MTNs was largely characterized by a central preoccupation with negotiating a more secure and enhanced trading relationship with the United States. With the conclusion of the FTA, we have started to consolidate that trading relationship within a bilateral framework and our MTN negotiators are now, for the first time in eight rounds, free to focus their primary attention on knocking down market access barriers in the Asia-Pacific and the European Community. British Columbia has emphasized this opportunity in our ongoing consultation with the federal negotiating team. Our negotiators should not be mesmerized by the "new" issues on the MTN agenda (e.g., services, intellectual property and investment) if this causes them to overlook the reality that there still are significant "traditional" market access barriers (e.g., tariffs and nontariff barriers) that impede our access to the Asia-Pacific markets and the European Community — particularly in the area of value-added resource products.

A second development on the Asia-Pacific front — the move towards enhanced and perhaps institutionalized Asia-Pacific economic cooperation — has an important bearing on Canada's commercial future. This movement was launched at the political level at a ministerial meeting held in Canberra, November 1989. Canada should strive to take a leadership role in this area. We cannot afford to remain on the sidelines.

British Columbia will be seeking an increasingly active involvement in Canada's strategy towards Asia-Pacific economic cooperation. Given our special relationship with the Asia-Pacific region, we will want to participate as much as possible in the development of the Canadian strategy and will be making strong contributions in our areas of specialization. British Columbia's Asia-Pacific activities not only deal with the "western" rim but with the "eastern" rim as well. Therefore, British Columbia is actively cultivating cooperative relationships with our colleagues in the western United States. A recent example of note has been our very successful initiative with the state of Washington — the Pacific Northwest Economic Partnership. This is developing into much more than a protocol and twinning arrangement; it is delivering some very substantive trade and investment results.

Finally, I would like to touch on two other items, in the broad area of infrastructure, which will require increasing provincial involvement in the future if our objectives of diversifying our trade and maximizing the role of the international dimension in our economic development are to be advanced. The first is in matters relating to transportation infrastructure and services. The provinces need a stronger role in the development of Canada's national transportation policies. One area in particular is in the negotiation of bilateral air agreements between Canada and other countries. We have to work to ensure that Canada has a world class transportation infrastructure to take advantage of, in our case, our geographic access to the Asia-Pacific market. In British Columbia, we are looking at various options in this area to upgrade the Vancouver International Airport and some of our port facilities. We are working with the federal government and local authorities to ensure that these are more than transportation facilities, but in fact economic development nexuses targeted at enhancing our access to the Asia-Pacific markets.

The second infrastructure issue is the development of our "human infrastructure" through immigration. Immigration has, throughout Canada's history, proven itself as an effective means of bringing new capital and entrepreneurial skills for deployment in emerging sectors in the Canadian economy. Federal immigration and recruitment policies based on a broad national approach lack the sophistication necessary to respond to and accommodate changing regional needs in terms of labour market requirements. Moreover, immigrants bring with them important links back into the markets of their home countries and, thereby, advance our market diversification objectives. In British Columbia's case, this is particularly relevant in developing our relationship with the Asia-Pacific region and with the European Community.

Previous conference speakers have noted how full the agenda is on the federal-provincial front today. However, it is easy to forecast that tomorrow's agenda will be much more challenging and will warrant closer and better cooperation between the federal and provincial governments in managing our economic relationships in a rapidly changing world.

Canada in the Global Context

Allan Gotlieb

I will try, from the standpoint of my own personal experience as a former diplomat, to take a very broad look at international change and how it affects Canada. I will talk about how global change is affecting our economy, our future as a trading nation, our prosperity and our standard of living. What I achieve in broadness may be at the cost of precision. If you disagree with what I say, that is fine. I promise to be provocative.

When one talks about Canada in the 1990s or the challenges that will face us at century's end one gets into the art of prediction. I was struck by the remark by one commentator, shortly after the Berlin Wall came down, that "Not since Copernicus have so many been so wrong so frequently with so little humility." So, please try to bear that in mind and be forgiving.

For Canada, our overwhelmingly most important international relationship is, of course, with the United States. I do not think there is any question that the era of the preponderance of American global power is ending. That, however, is a very different proposition from the statement that the United States as a nation is declining, or that the Free Trade Agreement was a mistake because Canada hitched its wagon to a falling star, or that somehow or other Canadians have lined up on the wrong side of history.

We do read a great deal of adverse comment here in Canada about the United States. I would not want to suggest that the U.S. has overcome or is on the road to overcoming serious social problems. We have focused very much in recent years on its lack of successes and they are certainly in evidence. But I do not think it is true that the United States is a country in decline. It is more true to say that that is a myth.

In the case of the United States, there are some quite impressive indicators of improved economic performance and of productivity and competitiveness. Statistics coming out of the United States — I am not a great one for rattling around data — are quite suggestive. The United States savings rate has recently approximated 6 percent, a good improvement over recent years. Last year their surplus in trade in services was over $60 billion. If one annualizes the overall U.S. trade deficit on the basis of fourth-quarter statistics, it would go down to $50 billion or so, although it is more likely to be about twice that — still an improvement. The growth in personal savings last year would be enough for the first time in a number of years to finance their budgetary deficit. United States manufactured exports have been increasing impressively. The United States' share of exports in the global economy has been going up significantly and it is now the world's largest exporter again. Those figures of steady decline in the percentage of world trade have been distinctly reversed. U.S. exports last year increased, I believe, about 9.5 percent, which followed several years of significant increase in export of manufactured exports. So the manufacturing industries in the United States are showing signs of becoming stronger and performing well. Their productivity is high and their competitiveness is high. There have been major changes in the way the United States manufacturing industry performs. They source their goods in ways that are quite different from the past — and more competitively. The vertical integration and supply lines are all being changed, as I'm sure many of you know, such as in the auto industry. So, the United States is showing very considerable signs of strength.

Beyond that, the U.S. is a tremendous target for foreign investment; the country is the world's number one financial haven. The strength of the U.S. dollar reflects this basic point. No doubt it is something of a mixed blessing for the United States, but nevertheless it reflects a vote of confidence in American stability and performance on the part of people in virtually every country. This has produced a large benefit for the American economy. A substantial flow of foreign investment continues to pour into the U.S. and this has increased substantially in recent years. One consequence is the growth of resentment among the U.S. public. One finds evidence on Capitol Hill of a great deal of protectionist sentiment. This is a serious matter and it is due in part to resentment of foreign investment especially of the high profile Japanese kind. The view that somehow or other Japan now represents the number one national security threat to the United States is quite astonishing. Articles in respected journals are really enough to knock one's eyeballs out.

The *New Republic* recently published a rather scurrilous leading article called "Yen for Power" about the Japanese which, in my opinion, sat somewhere between paranoia and xenophobia. You could summarize this article in the following way: the United States had now gone past the point where it could have an objective debate about relations with Japan. The Japanese, through their roughly $200 million of annual expenditures on American think tanks, universities, lobbyists, lawyers and public relations firms were now so much a part of the U.S. debate — they owned so many of the players, so to speak — that one could not have a balanced and fair debate about Japan in the U.S. That was the nub of the thesis.

I was rather shocked by it until I read just about the same thing in the *Wall Street Journal* a few weeks later, this time focusing on Carla Hills, the U.S. Trade Representative and all the former trade officials and their cousins and aunts who had a contract or a contact with some Japanese company. One reads more and more of this sort of thing in the U.S. press and it is distressing and depressing. But I think it is a mistake to focus too much on this as the main story, which is, I believe, that the United States' economy is doing well. Their basic industries are making significant adjustments. They are into their eighth year of growth and the last quarter was better than anybody thought. The U.S. is not in a recession at this time, and there remain signs of very considerable underlying strengths in the United States economy.

There are other good things happening in the United States. I was in Washington a few weeks ago for a few days and the buzz word in Washington was that it was "brain dead." Nothing is happening, says the media. Bush is not coming out with any new policies. He is behind the curve. And Speaker Tom Foley? Who is Foley? I mean, how do you spell it? And George Mitchell, what ever happened to Senate Majority Leader George Mitchell, we thought he was so smart? And the think tanks, they are dead, nobody's thinking in the think tanks. That is the message in Washington.

The *New York Times* published four articles, front page articles, on the subject of whatever happened to the mind of America. A popular analysis these days is that maybe it is really all the fault of the public. The public, they say, does not seem to like risks; so the message is do not get ahead of the public, do not lead, and if you are a politician then you better follow.

It would be a great mistake to write off again, or underestimate, the ability and strength of the President of the United States or his credibility among the public. The same is true for the present Speaker of the House of Representatives and Leader of the Senate. I think the United States enjoys quite impressive leadership at this stage compared to many other times in the United States. The Cabinet is one of the three or four ablest since the war.

One is entitled to get a little bewildered about why there is so much emphasis in the United States on the popularity of the president. Bush has around a 70-percent approval rating at the polls. Do you know that Bush is more popular today than any other president on this particular date at this particular week of a four-year cycle? One begins to wonder why does it matter so much that the president is popular? You know, I believe it does matter in the United States whether the president is popular. The reason is that the United States is an extraordinarily pluralistic society (sorry for the cliché) with power highly decentralized so the ability to change policy, to move the ship of state in any particular direction, is really quite marginal. The president is simply one player, albeit a highly important one. One of the greatest myths that has been perpetrated on world opinion and on the American public is the myth of the imperial presidency.

Congress, I believe, is the true receptacle of power in the U.S. and it exercises what seems to me to be executive as well as legislative power. The Congress proposes, initiates and disposes. That power, of course, is highly decentralized and atomized today and special interests really dominate the political environment in Washington. The President may have a higher charge in terms of his power, but he does not have all that much power and therefore his credibility is terribly important.

The ability to use the power of the presidency derives from the pulpit, from true leadership skills, from the ability to make deals with Congress, to get public opinion to reflect on or to react to Congress' behaviour. For example, right now the United States is on the threshold of a major piece of legislation. I believe it to be a landmark bill although history will determine that. I refer to the amendments to the Clean Air Act. Without the president's credibility and the credibility of the White House, that bill could never have been brokered. It has not passed yet, but it is likely to be the most significant piece of environmental legislation adopted in the United States in a great many years. The bill, by the way, will cost about $21 billion a year to implement and it will have enormous industrial consequences. When there are high costs to producers or consumers, when there are big losers and winners, when an important part of the economy is affected, leaders need credibility. And the president has it.

One also has, for the first time in the United States in many years, continuity in the White House. The discontinuities in the presidential system have at last been overcome. The United States, for some 30 years, has been electing permanent members of the Congress. The House of Representatives now has a 98 percent re-election rate. But the American people, at the same time, seem to want a revolution in the White House every four years. Hence the White House has in recent decades reflected the greatest possible discontinuities.

Every presidential candidate ran against Washington. Nixon ran against Washington with his Californians; Carter ran against Washington with the Georgians; Reagan ran against Washington again with Californians; Jack Kennedy ran against Washington with his coterie. The only person who has not run against Washington is George Bush and that is because he *is* Washington.

The result is that there is now real continuity and experience in the White House. One can rate them as Bill Safire does in the *New York Times*, one can say this one is good and that one is bad, but the fact is people like James Baker and Brent Scowcroft and Laurence Eagleburger and Richard Thornburh and William Brady and William Webster all represent continuity and experience. In recent years the average length of office of a high administrative official in the United States has been about 20 months. This gives one some idea of the churning and inexperience in Washington's corridors of power. On the Hill, however, there is, as I said, a 98 percent re-election rate in the House of Representatives. Some chairmen of committees have been there for ten, 20 or 30 years. Many of their staffers have been there since Methuselah. So the result is that the United States' system of governance now is benefitting from a higher degree of continuity in the administration than in any time in several decades. It is benefitting from a president with credibility and one who has restored strength and political power to the White House, complementing and completing what his predecessor Ronald Reagan had begun.

At the same time, U.S. industry has been undergoing deep change. There has been major restructuring in many basic sectors. Look at the number of jobs that existed in the steel industry ten years ago and count them today. As a result of such major changes, U.S. industry has been gaining considerable renewed strength and I think that is good news. The U.S. still remains the world's largest single market, the most stable market and a very good country with which to have a close economic relationship.

It is appropriate to ask ourselves how to deal with a country where there is such profound decentralization of power, where special interests drive the system, where there is an independent Congress which initiates legislation, which itself is highly fragmented and where party affiliations mean next to nothing. The true power centres in Congress are the chairmen of the Congressional committees and subcommittees. For these reasons, I think the Free Trade Agreement was conceptually sound. Some of you have heard me say this, but I believe that building up third-party institutions is the best way for a country to try to steady its relationship with the United States. That is because it is extremely difficult to resolve disputes with a country when there is no focal point of power, when the power is so decentralized. In the case of the United States, power is constantly moving and it is really very difficult to get an interlocutor who can deliver. The problem is all the more severe given the changing political mood of the country. Senator Benson said recently, "The days are over when the United States will sacrifice an economic interest for a foreign policy interest. The days are over when the United States will subordinate economic interests to a geopolitical one."

Beyond that I have become persuaded in my years in Washington and Ottawa that it is almost impossible in democracies to resolve many kinds of disputes. No country in fact can subordinate a domestic economic interest, no matter how local, to a foreign one. This is simply politically unacceptable. In a democracy, one cannot trade off. You cannot say to 200 potato farmers in Maine, "We like you, we love you, but we've got to test a cruise missile up there in Canada." The idea of such trade-offs is for journalists and other types of myth-makers. You cannot say to 200 potato farmers in Maine, "Sorry you lose. The 200 potato farmers in New Brunswick win." Likewise, no Canadian government (and we do not have a separation of powers), federal or provincial, is really able to subordinate a local or special interest to a foreign one. Bear in mind also a basic principle of modern democracy: the smaller the lobby the more effective it is. This is because if it is small it can be coherent and, if skilled in public relations, it can truly have a tremendous bite. Broad lobbies, however, are diffused and often do not know what they want so they can often be safely ignored.

The result of all this is that there is great paralysis in dispute settlement. Many economic conflicts arise from public policy differences in intensely democratic countries and public opinion legitimates these differences in each jurisdiction. Therefore, I think that the notion or the concept of third-party settlement is the best hope for a country like Canada, which wishes to retain its sovereignty and independence and not move into some kind of European-type super-federation; this is our best hope to obtain equitable results when disputes arise.

The Free Trade Agreement was far from perfect in that regard but it was a significant beginning and it did have some quite radical dimensions to it. It is true that conceptually it was not nearly as far reaching as the East Coast Fisheries Agreement in Mr. Trudeau's time. But the U.S. Senate refused to ratify that agreement. It would have created a genuine international body capable of managing our whole east coast fisheries resource. It failed but it was a major step in the direction of adopting new ways of settling disputes and I believe we are likely to see more of this type of thing.

There is one great drawback in third-party international dispute settlement and this has always been true in international affairs. The forum is not the biggest problem; the harder issue is what is the law to be applied? We have in the Free Trade Agreement been quite innovative in creating the forum and the panels, but the problem is the law. We do not have a common law to apply and that is why I believe it is in Canada's interest, perhaps even more than the United States, to get an agreement on subsidies. We need to have a common trade law so that the tribunals apply one and the same law. As the weaker country it is inevitable that we should rely more on international rules than the U.S., the larger power.

I want to say a few words about Europe and will then conclude. It is likely that the strongest growth rates in the world will be in Europe in the 1990s. We are going to see a great economic strength emerging from Europe; it will be the world's economic locomotive. It is not the time to go into all the reasons, but the European Community is bound to expand to cover most of the continent. It is not going to slip back and I do not believe it will even stand still for long.

Hungary, Poland and Czechoslovakia, in particular, are very strong candidates to merge into the European Community and all want in. East Germany is in effect already in. One reads the Germans wrongly in believing that, somehow or other, their interests would be served by some kind of weak community or a kind of detached Germany. I do not think that reflects the consensus in Germany and I do not think that is the way Germany will go. The European political institutions today are inchoate but the prospects are very high that we will see a European Community of at least 450 million people. Even if the 12 do not go much beyond where they are, they have already agreed with the EFTA six to try to form a single market for the movement of labour capital and goods. Within the community of 12, the movement towards supranational institutions is also irreversible.

We can also take it that the targets for 1992 will be reached; most of them have already been agreed to by the Commission. The growth rate has already been increasing as a result. There will be a vast single market of the 18 countries and it is likely that the 150 million or so in Eastern Europe will eventually be included in the Community as full members.

There is also some evidence to suggest that even for Chairman Gorbachev the European orientation is the most important; he sees the future of the Soviet Union or Russia linked to Europe. After all, who was the first leader to use the phrase "a common European house?" Gorbachev himself. Whether that happens or not we will see a Europe of 400-500 million forming a largely single economic community, perhaps a political super-state, and surging economic growth.

I would be delighted to be wrong, but I believe that what is happening in Europe confirms the trilateralization of the world trading patterns. After all, what will emerge from Europe is not a state. It will be a sort of political universe within a universe. It changes the basic concepts of the international order. In Canada we may find this confusing — to put it mildly — but what we are witnessing is the largest voluntary transfer of sovereignty in the history of the world. And let us remember that the Europeans invented national sovereignty. Now many of them are putting those toys away and driving strongly towards unity. The drive is there in the south, in Italy, in Spain — it is there in Denmark and public opinion is behind the Community in Britain, Mrs. Thatcher notwithstanding. The French are intellectually passionate (not just Jacques Delors) about a single Europe, and Germany will not try to make its destiny away from it. It is not to their economic or political advantage to do so.

The key point is that what is emerging is not a grouping of states but a form of super-state and it is linked to a large part of the world by preferential trading arrangements in Africa and elsewhere through the Lome Convention. So it is a trading universe and an economic universe and a unity.

The Europeans get very angry when you mention Fortress Europe to them. They say the Americans invented that phrase. Perhaps Max Baucus can take credit for it or Jack Danforth or some other protectionist-minded senator in Washington, but whether that is true or not, I am not entirely persuaded that the notion of Fortress Europe is entirely wrong. The Europeans are deeply offended by the idea. They say that is nonsense and they are certainly sincere. But if they succeed in their grand endeavour, absorbing East Germany, Turkey, Austria and Eastern Europe into the Community, then they are going to have to indulge in so many trade-offs, so many compromises, so many internal adjustments for so many years, that they may not be able to play by open international rules to the extent perhaps that many of them today think they would.

Moreover concessions may well have to be made to those members that are more protectionist, or addicted, to hidden barriers. The Japanese, in particular, may have a hard time accessing that market. The Americans are now becoming a principal instrument for supporting Japanese entry into Europe because the United States and Japanese industry are beginning to fuse and will continue to fuse. So we will see trilateralization but over the years the Europeans, Americans and Japanese will draw closer through common investments and global super-corporations. Indeed the best way in which these markets are penetrated is through investment and political participation. Canadian companies, some of them, are moving into Europe and some of them will do well, or at least a few of them, the ones that are making the necessary investment. Neither we nor others are likely to ship that many widgets from here to Europe. We are either going to participate in Europe as players or we are unlikely to enjoy fully the kind of benefits of the extraordinary growth that we can anticipate.

The Japanese are experiencing some domestic difficulties these days, but I think it is very shortsighted to think that it is not going to be onwards and upwards with the Japanese. It will be, unless their consensus breaks down. It is certainly not safe to predict that at this stage.

So we must learn to think differently about what kind of an economic and trading environment that is going to exist in the years ahead. We will find it essential to keep retooling our thinking. I certainly would not exclude the possibility of a North American free trade zone by the year 2000. Chancellor Kohl said last year, "It's not impossible that Hungary will be part of the Community by the year 2000." Hungary has already applied for associate membership and wants full membership as does Czechoslovakia and Poland. In the case of Mexico, maybe it will be the year 2000 before it has a free trade agreement with the U.S. and Canada, but I believe it will be much sooner. There are economic changes taking place in Mexico today of profound significance. Incidentally, the Canada-U.S. trade agreement will come to be seen as a major factor in some of the changed thinking in Mexico. Geopolitically it is desirable from a Canadian point of view that Mexico become part ultimately of a larger, North American, free trade area. The analysis has not been done, I suppose, about who benefits, who wins and loses if Mexico is part of a North American free trade zone with Canada in it. The idea produces a lot of negative reaction in some Canadian circles and the politicians do not seem warm to the idea at all, but politically it would change a lot in our relations in North America. Mexico is a country approaching 100 million people and I believe very important counterweights and counterbalancing forces could be achieved in a free trade zone on a continental-wide basis. Provided the negotiations were ultimately three-way and our objectives were skillfully kept in mind, we could get some major benefits out of that kind of relationship.

The Mexicans are going through a process similar to the one Canada went through in recent years. Mexico started off with an umbrella or facilitating trade agreement with Reagan and then Presidents Bush and Salinas announced they were going to seek sectoral free trade. That is exactly what Mr. Trudeau did in 1983 but in 1984 sectoral free trade was dead. I suspect sectoral free trade between the U.S. and Mexico is dead today because now the President of Mexico is considering a free trade agreement with the United States, a negotiation that might be launched in June of this year.

In conclusion, we are seeing major changes in the world not only in economic patterns but in political structures. We can no longer think of the international community as composed of self-sustaining independent units. To my mind — just a last thought — if there is any validity to the idea of Canada being a middle power, what is happening in Europe explodes that idea. The very notion of being a middle power means that one relates to a large group of other middle powers and in Europe there are no more middle powers. They were the backbone, the core of the middle-power grouping. It also included Egypt, Nigeria, Yugoslavia and others but the middle-power concept will never be the same. Indeed, as Europe integrates and the Soviet Union disintegrates, the whole structure of the international community is at the point of profound change. I believe that we will see federations form in other parts of the globe too. If Africa does not federate politically the outlook is going to continue to be very grim for them. There will not be one federation there obviously, but there may be several federations that will form.

Larger political federations is an idea whose time has come.

Canadians should remember.

Session III - Digest of Discussion

Canada-U.S.-Mexico

Allan Gotlieb did not believe that Canada had to be at the negotiating table with the U.S. and Mexico unless it wanted to negotiate a trilateral agreement. Diplomatic means will allow Canada to consult closely on the impact of such an agreement with Canada. Canada must decide if it wants to move as quickly as the Americans in concluding such an agreement. There would be several advantages from a U.S.-Mexico agreement for Canada. Such an agreement may have better processes and institutions for addressing common trade problems. The trade pact will also benefit American economic growth and, consequently, Canadian growth. A political benefit for Canada would be the presence of an additional countervailing power to the United States in continental trade discussions.

Allan Gotlieb suggested that Canadian involvement in a trade pact with its two southern neighbours is not necessarily imminent or inevitable but that Canada may eventually choose to become involved. Even the U.S.-Mexico arrangement would take time and be the object of opposition from U.S. domestic groups.

Trade with Japan

Allan Gotlieb was asked to reconcile his statement on U.S.-Japan trade cooperation with increasing American protectionism. First, he stated that the protectionist rhetoric and threats in Congress may not result in action since the Japanese cannot be easily excluded from the U.S. market due to their market and lobbying power in the U.S. The Japanese may need the U.S. even more if they cannot gain better access to Europe. Second, if there is a major recession, the U.S. may move to a comprehensive arrangement of managed trade with Japan rather than to wholesale protectionism.

He pointed out that Japan is inserting itself in the U.S. economy because it is in its economic interests, only part of which is due to U.S. protectionism. As an example of their common interests, Gotlieb cited the over U.S. $6 trillion of private savings in Japan that is being invested. The U.S. has an obvious interest in using this money.

Stuart Culbertson (British Columbia government) commented on the developing Japanese role in the Asia-Pacific region. He suggested that there are some traditional and historical fears of Japanese involvement, but that it is too early to tell how Asia-Pacific cooperation will evolve. To date, such cooperation has largely been led by Japan and the North American side of the Pacific must try to lead for their own interests but also because more players in the area will counterbalance Japan.

The Softwood Cases and the Provincial Role

Asked about the future role of Canadian federal and provincial governments in U.S. litigation under the FTA and U.S. trade law, Wayne Clifford remarked that the provinces had been substantially involved in the first softwood lumber case, contrary to suggestions in Doug Brown's paper. Allan Gotlieb and Carl Grenier also lauded provincial participation with the federal government in the first case. At that time three provincial ministers came to Washington together to work closely with Ottawa to explain Canada's position.

The provinces were even more involved in the second softwood case. Gotlieb said that the premiers were fully engaged and that he had met with them for a long discussion on softwood in Vancouver. Culbertson suggested that the second case taught the provinces the extent of the intrusiveness of U.S. countervail procedures on provincial policy and practices. This case and the second pork countervail showed the provinces that their policies were being directly challenged in the U.S. industry under existing trade law and that they should be involved in Washington with legal counsel to protect their interest.

Doug Brown recalled that American officials often sought documentation of policies that would exist in the U.S. but do not always exist in Canada. Gotlieb, Grenier and Hertzstein appeared to agree that the Canadian government was generally slow to realize the intense political rather than legal nature of the second softwood case and took some time to respond.

Gotlieb suggested that the provinces have the jurisdiction to determine the amount of stumpage but were not willing to accept the extent of the threat to their interests. He suggested that some of the key players such as Premiers

Lougheed and Bennett did not accept the need for changing the political strategy of their actions. He asserted that there was not a strong leadership on this issue from anyone in the country, including the federal level. In such cases with the U.S., we needed to make better political assessments and realize that the issue was not the provision of information, but to make our politicians at home realize that Canada was in deep trouble due to a surge in protectionist sentiment.

Murray Smith commented that the federal-provincial process may have restricted Canada's choices of action in responding to the second softwood case. After the preliminary decision in the softwood case in 1986, Canada had to decide whether to fight the case under U.S. trade law, to negotiate a suspension agreement or to seek an out-of-court settlement. Specifically, he suggested that a suspension agreement may have been preferable to the actual Memorandum of Understanding (MOU). Generally, this case illustrates how Canadian governments respond to these pressures in making quick decisions unlike trade negotiations that are more drawn out.

Gotlieb admitted that the relative merits of the MOU are debatable but asserted that the decision taken by Canada, though difficult, was correct. In addition, he said that Smith's suggestion of the illustrative nature of quick decision-making applies to the FTA since a large amount of it was negotiated in the last four days, leaving no time for consultation, or for responding to calls of nature.

Carl Grenier responded that Smith's suggestion that the provinces restricting Canadian choices was valid but should not be exaggerated. In the second softwood case, the federal and provincial governments may have lost some time after the preliminary determination due to over confidence from having won the first case under similar laws. The provinces were surprised that they lost the second case. Nonetheless, the consultative process with the provinces worked very well.

Robert Herzstein recalled effective provincial cooperation with the Canadian federal government and the Canadian forest industry in the first softwood case. Between the two softwood cases Canada was insensitive to the fact that despite trade law being on its side, politics was becoming a factor. There was a generalized lack of leadership or an inability to diffuse the political concerns before it became a crisis. The Japanese would have done better in that situation since they usually work on problems before they come to a crisis stage.

Herzstein suggested that before the second case the most visible signs of any problem came after the U.S. industry got to Congress. Congress used two threats over the executive branch. Contrary to the wishes of the Department of Commerce, Congress threatened to change the countervailing duty law to establish a natural resource subsidy and legislate a victory for the domestic industry. Also Congress threatened denial of fast track authority for the Free Trade

Agreement. Senator Packwood used that leverage to get certain informal commitments (which are still not fully public) from the executive branch about the handling of a suusequent countervail case on softwood. The lesson is that Canada was not then doing its job in Washington. In addition, though provincial collaboration appeared to be good, provincial ministers, particularly in B.C., were not all keeping a common front with the Canadian position. Continued vigorous consultation within Canada could have avoided this vulnerability that gave the U.S. industry the chance to gain from certain tactical advantages.

In responding to Herzstein's assertions, Gotlieb indicated that the embassy knew exactly what was happening but that no one in the government in Canada believed embassy reports of the political situtation due to their confidence in the law. He added that in the pork countervail case, congress legislated a solution even though Canada had won initially. Senator Baucus added a small provision in an Omnibus trade bill that permitted the case to later be won by U.S. interests.

Herzstein said he did not mean to fault the embassy but Canadian governments overall.

A conference participant from Noranda Forest agreed with Herzstein that provincial involvement was ultimately unhelpful to the final result in the softwood case. Despite federal and provincial agreement the softwood lumber industry is not happy with the resulting Memorandum, which removes softwood from usual trade channels, gives the Americans institutionalized oversight on Canadian forest policy, and will be very difficult to terminate.

David Barrows reiterated Ontario's opposition to the process that arrived at the MOU and to the final agreement.

Le fédéralisme canadien et les relations économiques internationales

John Ciaccia

Mesdames,

Messieurs,

Je suis particulièrement heureux de l'initiative prise par l'Institut de recherches politiques et l'Institut des relations intergouvernementales de l'Université Queen's, d'organiser une conférence sur une question aussi importante et actuelle que celle du fédéralisme canadien au regard des relations économiques internationales contemporaines; d'autant plus que l'on me donne l'opportunité d'exprimer mon point de vue en tant que ministre des Affaires internationales d'une province qui oeuvre depuis longtemps sur la scène internationale.

A cet égard, je rappelle que le Québec ouvrait sa première délégation étrangère à Paris en 1882 alors que l'Ontario avait fait de même à Londres, quelques années plus tôt, soit en 1869. Cette fois-là, ce n'était pas le Québec mais bien l'Ontario qui donnait le mauvais exemple!

Ce n'est pas à vous que j'apprendrai que nous vivons dans un monde d'interdépendance et d'intégration économiques sans cesse croissantes, où les échanges commerciaux internationaux, les mouvements de capitaux à court et à long terme, les politiques économiques et commerciales des Etats et des organisations économiques internationales influent sur l'économie mondiale et, en retour, sur nos économies nationales.

Les pratiques économiques et commerciales des uns influencent souvent directement celles des autres et réciproquement. De ces faits, est apparue l'indispensable nécessité d'une coopération internationale en matière de politique économique et commerciale.

Les signataires de l'Accord général sur les tarifs douaniers et le commerce en 1948, avec le souvenir encore très vif qu'ils avaient des années trente, avaient compris cela et bien plus: cette coopération allait aussi servir de fondement au maintien de la paix mondiale.

Parmi eux, se trouvait le Canada qui a été et demeure l'un des plus ardents acteurs et défenseurs du système multilatéral des échanges internationaux.

A plusieurs reprises, il a réitéré sa foi en faveur de la libéralisation des échanges économiques internationaux préconisée par le GATT et, plus récemment, porteur du même principe, il concluait avec son principal partenaire commercial une entente bilatérale de libéralisation des échanges basée sur les mêmes principes fondamentaux que le GATT.

Le Québec, sans aucune équivoque, partage cette vision de la réalité économique internationale, d'autant plus que son économie est liée principalement aux échanges économiques internationaux, qui se font notamment avec les Etats-Unis. L'appui du Québec aux négociations et à la conclusion de l'Accord de libre-échange avec les Etats-Unis témoigne d'ailleurs de cette vision.

Les échanges commerciaux du Canada avec ses partenaires sont donc vitaux à l'économie canadienne, qui a l'une des économies les plus ouvertes des sept pays les plus industrialisés. Les comptes nationaux trimestriels de l'OCDE de 1989 indiquent que le Canada exportait en 1988, 26.1% de sa production de biens et services et expédiait 73% de ses exportations aux Etats-Unis.

Dans le cas du Québec, en plus de ses exportations de produits primaires et d'énergie, il exportait à l'international, en 1988, 30% de sa production manufacturière. Une étude récente indique qu'au Québec, un emploi sur trois, dans la production de biens, dépendrait du commerce international.

Par ailleurs, la réglementation économique internationale a de plus en plus tendance à régir l'économie interne des Etats, par le contrôle qu'elle exerce notamment sur les barrières non tarifaires. Il devient donc de plus en plus difficile de dissocier l'économie externe de l'économie interne.

Dans le cas d'une fédération comme celle du Canada, cette tendance internationale a comme effet aussi de toucher directement aux compétences des provinces qui assument, dans une large mesure, la responsabilité de leur développement économique interne au plan gouvernemental.

Pour illustrer ces questions, je limiterai mon intervention à nos relations commerciales avec les Etats-Unis dans le cadre de l'Accord de libre-échange et celles prévues à l'intérieur du cadre plus général qu'est celui du GATT.

Je désire m'arrêter sur ces deux réalités. D'abord le fait que *les provinces font du commerce international* et qu'ensuite *elles agissent sur lui*. Je prendrai l'exemple du Québec.

Dans la loi constitutive du ministère des Affaires internationales, la responsabilité du ministre est de proposer des politiques qui doivent favoriser le développement du Québec, entre autres, sur les plans commercial et économique.

La recherche d'investissements, le développement de coentreprises, la recherche de débouchés dans le but d'exporter les produits et services québécois, l'acquisition et le transfert de technologies de pointe, la promotion de l'industrie touristique sont autant d'exemples qui font l'objet de notre attention et de nos efforts quotidiens.

Pour nous assister dans cette tâche, le Québec peut compter sur un réseau de 26 délégations et bureaux à l'étranger et un budget dépassant les 100 millions de dollars. Dans plusieurs domaines, nous traitons directement et de façon autonome avec l'étranger et nous avons développé une expertise en matière de questions économiques internationales.

D'autre part, les provinces jouent un rôle clé dans le développement de leur économie interne. En vertu des pouvoirs qui nous sont dévolus par la Constitution, nous assumons, par divers moyens, le développement de nos ressources naturelles, de notre agriculture, de notre secteur manufacturier; nous élaborons des politiques industrielles, des politiques de soutien à la recherche et au développement sans oublier l'aide à l'exportation.

Dans ce dernier domaine de l'aide à l'exportation, dont mon ministère est le maître d'oeuvre, c'est plutôt d'aide technique qu'il s'agit: les PME, qui ont un potentiel à l'exportation, sont très souvent dépourvues d'informations quant aux occasions d'affaires dans les marchés étrangers, quant à la façon de pénétrer ces marchés qui, même pour un marché qui nous est aussi proche que celui des Etats-Unis, peuvent différer considérablement des nôtres.

Ces interventions dans notre économie interne ne sont pas cependant sans affecter nos relations commerciales, et celles du Canada, avec nos partenaires commerciaux. Nous avons eu l'occasion de nous en rendre compte particulièrement lors d'enquêtes en droits compensateurs initiées par nos voisins américains, mais aussi, au niveau multilatéral où les provinces ont été amenées, par l'intermédiaire du gouvernement fédéral, à s'engager devant les Parties Contractantes du GATT dans le différend relatif aux monopoles provinciaux des alcools, sur lequel je reviendrai plus loin.

This brings me to the other reality, the increasing control of domestic economies by international economic law.

In Canada, the provinces, within their respective jurisdictions, may adopt measures that could at times be barriers to trade. Provincial procurement policies, agricultural policies, policies on developing and exporting natural resources, marketing alcoholic beverages, grants to companies and various provincial laws governing commercial activities and protecting consumers are

examples of interventions that may influence the flow of trade, and are therefore likely to be monitored and, in some cases, controlled at the international level.

This trend was especially evident during the Tokyo Round talks on government procurement policies, subsidies to local industries and technical standards for products.

At the close of those negotiations, three codes, in addition to the federal clause in Article XXIV (12) of the General Agreement, referred to provincial governments or contained a so-called federal clause requiring federal contracting parties to take all reasonable steps to ensure that local governments comply with the provisions. The three codes cover subsidies and countervailing duties, technical barriers to trade and trade in civil aircraft.

With these clauses, the international community has obliged federal governments to ensure that their political subdivisions honour the commitments they have made. At the same time, political subdivisions, like the provinces, were asked to abide by these commitments.

Government capacity to influence the development of the domestic economy was affected to some extent.

The current Uruguay Round of negotiations under the GATT is following the same trends and dealing with issues that are important for Québec and the other provinces. There would be new provincial requirements, for example, if the government procurement code was extended to local governments or if an international agreement was reached in the service sector. Compliance with new international standards would be among these requirements.

This is why Québec and the other provinces want to be partners in formulating the Canadian proposals that have been or will be tabled at the GATT. We want to ensure that the interests of the provincial governments are taken into account.

One consequence of this trend towards greater international control of the domestic economy is that some contracting parties are looking more closely at our interventions. I am thinking specifically of the complaint about provincial liquor boards, including Québec's, that was voiced by the EEC and the United States during the Tokyo Round.

It referred, among other things, to the discriminatory marketing of alcoholic products and preferential mark-up differences between local and imported wines.

Pressure from other contracting parties led the provinces to commit themselves by signing a letter of intent regarding practices that are considered discriminatory to imported alcoholic products. This commitment did not produce the expected results because some provinces, including Québec, changed their practices in the early 1980s.

The EEC then requested that a GATT panel be called on the grounds that our practices infringed upon Canada's international commitments. The panel reviewed the compatibility of our laws, regulations and practices in the light of GATT rules. They were ultimately declared incompatible with certain provisions in the General Agreement.

The panel's recommendation was confirmed by the GATT Council. In December 1988, Canada, with the active involvement of the provinces, reached a negotiated agreement with the EEC to enforce the GATT decision.

These events show both the international scope of provincial activity and the necessity for the provinces to assume their responsibilities within the international community. Even more obvious is the importance of ensuring close cooperation between the provinces and the federal government, particularly where provincial jurisdiction is at issue.

This affair proved that the federal government and the provinces can make positive contributions to settling disputes involving the provinces.

Our principal trading partner, the United States, has long been aware of the important role the provinces play and of our interventions in international trade. American authorities have not hesitated to take steps to counter the effects of our industrial aid policies by levying countervailing duties on some of our exports.

There have been disputes over lumber, groundfish, hogs and more recently, pork.

The Canadian-American lumber conflict has also shown the federal government's interest in involving the provinces in settling the dispute. The close collaboration of the two main producing provinces, British Columbia and Québec, has made it possible to considerably decrease the 15 percent export tax the Canadian Government had to levy in order to head off an American countervailing duty. The export tax has been lowered to zero for British Columbia and 8 percent for Québec.

Mais la nécessité d'impliquer les provinces dans les relations économiques internationales s'est particulièrement fait sentir lors des négociations bilatérales sur l'Accord de libre-échange où les Etats-Unis ont soulevé la question de l'engagement des provinces dès le début des négociations; en clair, les Américains voulaient s'assurer que le nouveau cadre applicable au commerce bilatéral entre les deux parties ne puisse être mis en échec par d'autres ordres de gouvernement.

J'ai déjà mentionné que les provinces avaient été consultées au moment des négociations multilatérales du Tokyo Round. Déjà en avril 1973, quelques mois avant le lancement du Round, le ministre québécois de l'Industrie et du Commerce d'alors, Monsieur Guy St-Pierre, revendiquait une forme de participation à ces négociations.

Mais la négociation de l'Accord de libre-échange avec les Etats-Unis marque un tournant majeur à cet égard. Après des représentations similaires de la part des provinces, le Premier ministre du Canada énonçait en novembre 1985 le

principe de la "pleine participation" des provinces aux négociations avec les Etats-Unis.

Par la suite, les rencontres des premiers ministres, des ministres et des hauts fonctionnaires se multiplièrent. On connaît la suite des événements.

De notre point de vue, cette attitude fédérale éclairée a grandement contribué au succès des négociations, et à une mise en oeuvre qui procède normalement, même dans les matières de compétence provinciale, dont la mise en oeuvre nous appartient.

Malgré certaines exclusions ou clauses d'antériorité, les provinces sont visées par les dispositions du chapitre 5 sur le traitement national, certaines dispositions du chapitre 7 relatives à l'agriculture, celles sur les vins et spiritueux du chapitre 8, la fourniture de services visés au chapitre 14, les autorisations de séjours temporaires pour gens d'affaires du chapitre 15 et les investissements du chapitre 16.

Mais en plus des dispositions de l'Accord de libre-échange qui affectent les compétences des provinces, il y a aussi les matières de compétence fédérale qui peuvent requérir la collaboration des provinces surtout lorsque ces matières portent sur des mesures qui ont un impact majeur sur l'économie des provinces.

Le différend canado-américain sur le saumon et le hareng a démontré que le gouvernement fédéral comprend l'utilité d'impliquer la province la plus directement concernée, la Colombie-Britannique, dans la préparation de la position canadienne devant le Groupe spécial d'experts qui fut appelé à examiner le différend.

Lorsque le Canada conteste des mesures américaines qui peuvent avoir un impact sur l'économie des provinces, la participation de celles-ci peut être bénéfique. C'est le cas notamment de l'actuel différend sur le homard, où les provinces de l'Atlantique et le Québec collaborent à l'élaboration de la position canadienne.

D'autre part, le Canada et les Etats-Unis ont convenu, pour le futur, d'élargir la portée de l'Accord de libre-échange en prévoyant des négociations bilatérales afin d'étendre les obligations actuelles prévues aux chapitres des normes techniques, des marchés publics, des services, etc., et d'établir une nouvelle réglementation en matière de subventions et de droits compensateurs.

Tous ces secteurs de négociation à venir sont actuellement réglementés, en tout ou en partie, par les provinces. La même logique d'étroite coopération qui a prévalu pendant la négociation de l'Accord devrait continuer à s'appliquer pour l'extension de l'Accord.

It seems clear to me that the provinces make use of several of the powers that interest international economic law, or to put it another way, that the provinces fall directly within the provisions of international law.

In fact, I would even say that there is a direct relation between the provincial activities and the control international economic law exercises over the

behaviour of nations. The absolute separation of constitutional jurisdiction over external trade and internal trade has crumbled, in part because of the control that international economic law has come to exert over nontarriff barriers.

In the context of current international economic relations and in the present-day constitutional order, there is no question but that the federal government should have the support and cooperation of the provinces when it undertakes negotiations leading to international commitments that expressly or implicitly restrain the provinces and whose implementation depends largely on provincial constitutional jurisdiction.

In this regard, the principle set forth in the 1937 labour agreements affair is still the position of Canadian constitutional law. That principle is that the federal parliament may not, by means of a law or ostensibly by means of commitments consequent to treaties, appropriate a jurisdiction with which it has not been specifically entrusted under the constitution.

It is for precisely for this reason that the Gouvernement du Québec vigorously opposed Articles 6 and 9 of the federal law implementing the Free Trade Agreement. Article 6 reaffirmed the federal parliament's power to implement the Agreement "in whole or in part" and Article 9 made this power specific in the case of obligations respecting alcoholic beverages in Chapter 8 of the Agreement.

Québec adopted the measures required to implement the provisions of the Agreement that fall within its legislative jurisdiction.

The federal government implicitly recognizes that the provinces have a role in international economic relations. We were involved in negotiations on the Free Trade Agreement and we are now involved in the Uruguay Round of multilateral trade negotiations and in seeking greater provincial participation in managing the Free Trade Agreement with the United States.

Mais la consultation, sans une véritable participation, n'est plus un moyen suffisant pour un Etat fédéral comme le Canada, s'il veut répondre adéquatement au défi posé par la réalité de l'interdépendance économique internationale. Les provinces se sentiront d'autant plus liées par des obligations internationales auxquelles elles auront été véritablement associées et qui tiendront compte de leurs intérêts et de leurs préoccupations.

Sans une véritable association entre le gouvernement fédéral et les provinces, il deviendra difficile pour le Canada de garantir l'exécution de ses obligations internationales.

Jusqu'à maintenant, l'implication des provinces dans le règlement des litiges commerciaux s'est faite d'une façon ad hoc, au cas par cas et sans trop de heurts; la manière pragmatique qu'ont su développer ensemble le fédéral et les provinces doit maintenant être formalisée, sans qu'on cherche pour autant à modifier l'équilibre des pouvoirs en matière de négociation et de mise en oeuvre des accords commerciaux internationaux.

En fait, je dirais que le défi que posent les relations économiques internationales au fédéralisme canadien comporte d'une part, pour le gouvernement fédéral, une reconnaissance explicite du rôle des provinces dans le domaine des relations économiques internationales et d'autre part, pour les provinces, une plus grande responsabilisation face à l'existence de la norme internationale.

Pour cela, des ajustements sont nécessaires des deux côtés.

Déjà l'Accord de libre-échange, par son article 103, reconnaît expressément le rôle et l'importance des provinces dans les relations commerciales du Canada avec les Etats-Unis. Cette reconnaissance internationale devrait, à notre avis, s'accompagner d'une reconnaissance nationale, laquelle ne peut se faire qu'à travers des mécanismes formels assurant notre participation dans la mise au point des positions canadiennes.

Lors des négociations de l'Accord de libre-échange avec les Etats-Unis, le Québec avait posé certaines conditions à son appui, dont celle de participer à la gestion de l'Accord ainsi qu'aux mécanismes de règlement des différends qui y sont prévus. Pour le Québec et les autres provinces, une des façons de nous assurer d'une véritable participation est la conclusion d'une entente fédérale-provinciale sur la participation des provinces à la gestion de l'Accord de libre-échange.

Cette entente pourrait s'étendre aux résultats des négociations commerciales multilatérales, selon les résultats éventuels du Round en cours.

Les provinces ont demandé au gouvernement fédéral la conclusion d'une telle entente. Un projet a d'ailleurs été présenté par le Premier ministre du Québec, au nom des Premiers ministres des provinces, au Premier ministre du Canada, à l'automne dernier.

Le Québec et les autres provinces demandent notamment que soit confiée aux ministres fédéral et des provinces responsables du Commerce extérieur, travaillant de concert, la responsabilité de déterminer les lignes directrices ayant trait à la gestion, la mise en oeuvre, la négociation et l'élargissement de l'Accord de libre-échange et, éventuellement, de considérer d'autres aspects des relations commerciales bilatérales et multilatérales. Pour assister les ministres dans leurs fonctions, il y aurait un Comité fédéral-provincial de hauts-fonctionnaires dont le mandat serait de conseiller les ministres.

Les provinces demandent aussi une participation effective aux mécanismes de règlement des différends, à travers les diverses étapes qui sont prévues dans l'Accord, notamment lorsque des mesures provinciales sont l'objet de consultations ou d'un différend, ou lorsque les consultations ou le différend soulèvent des questions d'intérêt économique majeur pour elles.

Suite à une conférence fédérale-provinciale des ministres responsables du commerce extérieur en novembre dernier, quatre rencontres ont eu lieu entre les fonctionnaires responsables des deux ordres de gouvernement. Le but poursuivi, selon un cadre qui reste à convenir, est celui d'une entente formelle qui nous assure d'une participation véritable et effective à la mise en oeuvre et à l'élaboration de l'Accord.

J'ai bon espoir que nous en arriverons à une entente pragmatique, qui assurera aux provinces un rôle constructif, pour une gestion efficace des relations économiques internationales au Canada, et ce, dans l'intérêt du pays tout entier.

En terminant, je souhaite que les discussions de cette conférence puissent nous éclairer encore davantage sur la nouvelle relation fédérale-provinciale qui se développe au regard des relations économiques internationales contemporaines.

Je vous remercie de votre attention.

IV

Developing Trade and Investment Strategies

Globalization: Lessons for Canadian Investment Policy and the Federation

Alan Nymark

Today few conversations about the international economy take place without reference to globalization. Our conference is testimony to this fact. At Investment Canada, globalization is certainly part of our daily activities. More than ever before direct and portfolio investment are moving freely across borders, both in and out of Canada.

Global realities bring new pressures to bear on Canada's investment policy framework. Canada's trade and investment strategies must fully recognize the scope and nature of globalization.

But what do we mean by the concept "globalization"?

Globalization

Globalization of markets can be defined as "the integration of markets on a global scale." (See Figure 1) More and more, corporations must both plan and operate on a global scale. They manufacture, provide services, conduct research, raise capital and buy supplies wherever these activities can best be done, regardless of nationality.

Factors driving globalization include:

- growth in world trade and foreign direct investment;
- increased openness of major economies;

- industrial rationalization world-wide;
- international networking and other forms of strategic alliances among firms; and
- the growing importance of European and Asian markets.

Rapidly increasing trade and investment flows are testimony to a more interconnected and interdependent global market. (See Figure 2) Since World War II, growth in world trade and investment has outpaced world output. The 1986-87 period was one of particularly strong growth in world trade, expanding at more than 17 percent annually.

During the past decade, however, international direct investment has challenged trade as the principal vehicle of international commerce. This is reflected in the fact that international direct investment worldwide grew by a staggering 24 percent in 1987, and early data suggest very rapid growth in 1988 and 1989.

The growth of portfolio investment has even surpassed that of direct investment. This demonstrates the very significant impact of the deregulation of financial markets globally, and how it paved the way for borrowers to turn to capital markets rather than bank credit as the source for their funding.

For example, during 1980-87, the stock of outward portfolio investment of the U.S., Japan, the U.K. and Canada combined rose at an average annual rate of over 27 percent. This compares to the growth of over 10 percent in world stock of outward direct investment; about 3 percent in world merchandise exports; and 2.6 percent of world output during this same period.

Nowhere are the investment challenges clearer than in the U.S. Since 1986 the flow of foreign direct investment to the U.S. has more than doubled; its stock of foreign direct investment (FDI) as a percentage of total net worth of non-financial corporations has increased from over 6 percent in 1986 to close to 9 percent in 1989; the level of U.S. corporate bonds and stocks in foreign hands — one measure of foreign portfolio investment in the U.S. — grew at an average annual rate of 23 percent from 1980 to 1988; and the Japanese share of these assets jumped from less than 2 percent to over 12 percent during the same period.

This growth of world trade and investment has led to more open industrialized countries. For the G-7 countries as a group, exports as a percentage of GDP increased from just under 10 percent in 1960 to just below 15 percent in 1987. Canada's degree of openness rose by almost 10 percentage points during this same period, making its already open economy more so. (See Figure 3)

The lowering of tariff barriers in the successive GATT rounds, the deregulation of certain sectors across the industrialized world, and the improved transportation and communications systems have all played their part in these developments. The implementation of the Canada-U.S. Free Trade Agreement (FTA), the developments leading to Europe 1992, the liberalization of Eastern Europe, and the so-called "new issues" now being addressed in the Uruguay Round promise the continuation of this long-term trend to global interdependence.

As investment has challenged trade as the main vehicle of international commerce, a much more balanced participation in investment has emerged among western industrialized economies. (See Figure 4)

The stock of international direct investment has increased almost eight-fold (in nominal terms) during the past two decades. Since World War II, the U.S. has traditionally been the dominant source country of investment, but its share of the world stock of FDI fell from 50 percent in 1967 to less than one-third of the total in 1987.

As the U.S. role has shifted, both Japan and West Germany have become major economic players once again. Following the devastation of the war, West Germany now accounts for almost 10 percent of the world stock of direct investment abroad; Japan for 7.5 percent of the total.

Foreign investment flows show even more sharply how rapid changes are occurring in the participation of western industrialized countries in global investment activity. (See Figure 5)

During 1971-80, the U.S. accounted for 44 percent of world cross-boundary direct investment flows; from 1981-86, it contributed only 19 percent. The U.K., which made up 22 percent of direct investment flows from 1981-86, was in fact a larger player than the U.S. during this period. The most dramatic change has occurred with respect to Japan's share of investment flows. During 1971-80, it made up 6 percent of world cross-boundary direct investment flows; from 1981-86, Japan's share had risen to 14 percent of the flows. Canada's participation has also increased. During 1981-86, Canada's percentage contribution rose by 50 percent, and Canadian sources now account for 6 percent of world direct investment flows, putting the nation on a par with France.

Mergers and acquisitions (M&A) are perhaps the most visible evidence of globalization. In the global economy, rationalization of industries is occurring on a worldwide scale coincident with the marked rise in foreign investment and with the trend towards a more balanced geographical dimension of investment activity. (See Figure 6)

Of the major OECD countries, Canada, the U.S. and the U.K. have experienced the most substantial amount of M&A activity. In Canada, the number of mergers and acquisitions is surprisingly high relative to those in the U.S. The ratio (of Canadian M&A activity to U.S. M&A activity) was about one to three, rather than the one to ten ratio that traditionally applies between Canadian and U.S. indicators.

From 1987-88, M&A activity has picked up in the EC and the EFTA (European free trade association countries), likely reflecting in part the anticipated benefits of Europe 1992. Japanese M&A activity remains at a low level for two main reasons — Japan already has highly integrated manufacturing and financial sectors; and, foreign takeovers are rare because of the formal, and perhaps more important the informal, barriers to outside participation in the Japanese economy. (See Figure 7)

Not only is M&A activity in Canada growing — in recent years at double its level in 198[illegible] it also has taken a different shape. During 1989, M&A activity in Canada was marked, unlike in the recent past, by a relatively high incidence of large transactions (e.g., Imperial/Texaco; Stone/Consolidated Bathurst; Noranda/Falconbridge; Socanav/Steinberg; BCE Inc./Montreal Trust). Foreign acquisitions accounted for almost half of the total $30 billion M&A activity in this year, although many — half again — involved takeovers of Canadian-based but foreign-owned firms.

A picture of Canadian M&A activity would not be complete without reference to "Quebec Inc." and its unique approach within Canada. The commitment to the goal of fostering "mammoth" Quebec corporations linking financial and commercial interests is not found elsewhere in the country. The caisse de dépot, the Mouvement des caisses Desjardins and other financial agents are participating closely with the Quebec business sector to this end.

M&A activity is not the only illustration of globalization. International networking of firms is another major element. Corporate alliances are rapidly becoming an important strategic new option touching every aspect of world industry from small to large companies, from sunrise to sunset industries, and from manufacturing to services.

The drive to form strategic alliances is fuelled by a wide range of pressures. These include the high cost of technology development and commercialization, coupled with the recognition that products costing hundreds of millions of dollars to develop may have life spans of less than two years. Only a global product that can be quickly transmitted to the major markets of North America, Western Europe and the Pacific Rim could justify this type of risk.

Over the next decade, competitive advantage will be based more than ever before not only on a firm's internal capabilities, but also on its arrangements with other companies. Recognition of this fact is driving leading-edge companies to compete actively for allies. (See Figure 8)

Northern Telecom is an example of a Canadian company that is very involved with international networking and strategic alliances. Northern Telecom has extensive linkages with other firms across the globe (e.g., Hewlett Packard, Apple, Data General, Dec, Wang, Honeywell-Bull, NCR, Novell, Prime, Unisys). There are also joint ventures with firms in Australia and China, strategic alliances with 9 firms in the U.S., and licensing agreements with various firms in Europe.

Another fundamental element of globalization is the emergence of countries, or groups of countries, that challenge the trade dominance of the U.S. As demonstrated, the participation of Asian and European countries in world trade is much stronger in today's global markets than it was just after the war. In fact, world trade promises to be even more diversified as commercial ties grow with the Pacific Rim and in response to the recent liberalization of Eastern Europe. (See Figure 9)

For Canada, these trends should help reduce the dominance of the U.S. market and change its composition of trade. According to DRI (Data Resources International), Canada's exports to the Pacific Rim are expected to double between 1988 and 1992 (relative to the preceding four-year period). Canada's exports to the EC are to increase by more than 80 percent. However, Canada's exports to the U.S. are expected to rise by only 25 percent. Nevertheless, since the U.S. accounts for such a large share of exports today, it will continue to offer the greatest absolute dollar increase in export opportunities.

Lessons for Canadian Investment

What are the implications of globalization for Canada and in particular for Canadian investment strategies?

The first lesson of globalization is that the persistently high rates of growth in world trade and investment make Canada "open for business." There are really no viable policy choices in this respect for industrialized countries.

In the face of global markets, Canadian firms are subject to more and more competitive pressures to forge international linkages. Today's global firms aim to maximize the benefits of global strategies and local knowledge to achieve scale economies and targeted marketing.

In response to these trends, Robert Reich in his recent Harvard Business Review article, "Who is us?" has argued that he doubts the value of policy-makers focusing on the nationality of corporations. He concludes that governments should encourage competitiveness of a nation's workforce, not its flag-bearing corporations. In effect, the conceptual distinction between "domestic" and "foreign" firms is more and more in question.

For Canadian governments, "open for business" in the global economy also means international and domestic policies relating to trade and investment will be more than ever blurred. Globalization enhances opportunities for joint trade and investment gains with other countries, but it also magnifies vulnerability.

It is precisely in light of this growing global interdependence that the current Uruguay Round is, for the first time, addressing the liberalization of the international investment environment, the so-called trade-related investment measures (TRIMS). It is also why the bilateral U.S.-Japanese structural impediments initiative talks may have a profound impact on the way other G-7 countries view access issues, including investment, in the future.

The second lesson of globalization is that international investment is challenging trade as the principal vehicle for international commercial transactions.

From this perspective, Canada's investment flows and stocks are relatively more significant to the macroeconomic policy mix. This relative increase in the importance of investment leads to less autonomy and fewer degrees of freedom over our macroeconomic mix. This development underlines again the need for international coordination of macroeconomic policies, including investment policies, and for considering the appropriate mix of fiscal and monetary policy in Canada given the requirements of international coordination.

In recognition of the principal role of investment in international commerce, Canadians must accept that Canadian direct investment abroad plays an integral part in the investment framework. In other words, investment is a *two way street*, and investment strategies must recognize this fact. Canadian business must be in a strong position to compete with foreign business both in Canada and abroad. Canadian-based global corporations are few and far between.

A third lesson of globalization is that Canada must be prepared to meet the challenges of industrial restructuring as part of the competitive imperative.

Confronted by these global challenges, Canada has no choice but to meet international standards in a wide range of areas essential to the microeconomic policy framework — for example, industrial R&D and technological development in Canada; education and training; competition policy; the cost of capital; transportation and communication services; industrial-regional development policies; and interprovincial barriers to trade.

A crucial related issue that Tom Courchene has raised in his analysis of "Quebec Inc." is the appropriate financial infrastructure in Canada, and specifically the degree to which governments permit links between financial and commercial institutions. In Canada, we are experimenting with these linkages in some jurisdictions and in some parts of the financial sector. It is an important question if we are to provide the necessary stable, economic framework that promotes strong inward and outward investment.

Creating a positive investment climate is essential. Most developed countries offer similar industrial infrastructures, and Canada's comparative advantages can be found elsewhere, or if not, duplicated rapidly.

Investment promotion has a central role to play in addressing these challenges of global industrial restructuring. Our goal must be to attract value-added investment with a view to increasing capital-technology flows, productivity growth, competitiveness and Canadian employment. Our emphasis should be on greenfield investments and strategic alliances to build our human and capital infrastructure. Ownership and control are less important than performance and value added.

A fourth lesson of globalization is the new geographical dimensions of trade and investment. In global markets, we have witnessed the relative decline of the U.S., the emergence of the Pacific Rim and Western Europe, as well as the liberalization of Eastern Europe. The developing world is watching carefully the impact of this shifting pattern on their chances for greater participation in the world economy.

Investment strategies in this context must support the broadening of international exchange with these various regions. Canada has the FTA in place, and through it, will consolidate its access to the North American market. As a result, Canadian firms will be in a much stronger position to meet the challenges of globalization.

It is an open question, however, whether Canada can be in all regions at all times and with the same level of commitment. Investment strategies for each region must take into account what Sylvia Ostry has recently called, "the marked differences in the political economy of trade policy-making in the triad." What Canada does to promote investment in and from the Pacific Rim may be very different in kind and scope from its initiatives in Western and Eastern Europe.

To build on these lessons, there are two specific areas where Investment Canada will be dedicating some considerable resources for research over the next year:

- the relationship between foreign investment and technological change, where the fundamental issue is how to maximize the value-added of foreign direct investment in terms of R&D activity; and
- the impact of M&A activity on Canada — a lot more needs to be known about how M&A activity affects the structure and performance of the Canadian economy and its corporations since we anticipate that the high level of M&A activity will continue in the 1990s.

Lessons for the Federation

Let me conclude with a few words about globalization and federalism.

Recent years have been marked by a growth in the volume and variety of provincial international activity. This activity is maintained by various provincial departments depending on the issue at hand — for example, provincial trade, industry, agriculture, energy and environment departments all have international dimensions.

In the investment field, it is no different. Provincial governments from B.C. to Newfoundland have the job of encouraging and securing investment, marketing their economies, and identifying offshore high value-added products and services that could bring them major benefits.

This activity and its scope demonstrate that, like the federal government, the provincial governments are "open for business." In 1988, Premier Peterson said in Davos, Switzerland:

> Our horizons are not limited to the borders of Canada, nor even of North America...Our mission is to be a global trader: we are committed to vigorously pursuing mutually beneficial trade and investment relationships with every other part of the world.

These words refer, of course, to Ontario, but we have all heard the other nine premiers say similar things during the last decade.

Federal and provincial governments alike have no choice but to *look outward*. The intense competition in our global markets knows no political boundaries. In a global, interdependent world, provincial programs and policies can no longer be made in isolation, and without consideration of their impact on other governments domestically and internationally.

Perhaps the greatest global challenges for the federation arise from the pressures of industrial restructuring. To meet these challenges, all our governments must position themselves to promote change, not to retard it. Yet there are so many sensitivities to change constraining governments today.

Investment policies contribute to, and overlap, industrial, regional and R&D policies. These very policies are now, and will continue to be, the subject of international rules — for example, through negotiations on trims and subsidies.

Such international rules have the potential to directly affect our programs. In the Japanese-U.S. structural impediments initiative talks, the bilateral negotiations are dealing in a comprehensive way with the nuts and bolts of commerce, such as licensing for shopping centres. Recalling the public debate over the FTA, Canadians might well wonder just how far does this process of globalization go.

One thing is clear. The global economy makes interprovincial trade barriers and the competitive subsidy practices of provincial governments *mug's games*. Real progress must be made in their elimination and the establishment of domestic rules that will promote a Canadian common market.

When global forces are freeing the borders of nations and bringing with them fierce competitive pressures, no level of government can reasonably aim to protect the status quo, or to insulate its regional economy from such rapid changes. Instead, Canadian governments must maximize their opportunities from globalization, while at the same time reinforcing their *legitimate* domestic interests.

To this end, federal and provincial governments must put a premium on a high degree of cooperation. In a global, interdependent society, the potential for governments working at cross purposes is high — with much scope for real economic damage to the Canadian economy.

The bottom line is that federal and provincial governments must share their perceptions on globalism and investment. The task is to encourage federal and provincial governments to work together on:

- a common perception of the complex relationships between globalism and investment;
- complementary investment promotion strategies; and
- a common understanding on individual review cases, and in particular on the balance struck in these case between global forces and domestic sensitivities.

In the investment area, the federal-provincial process has been, and is, working well. But *much more needs to be done* if we are to meet the challenges of globalization successfully in our federation.

* * *

Figure 1

The "Globalization" of Markets

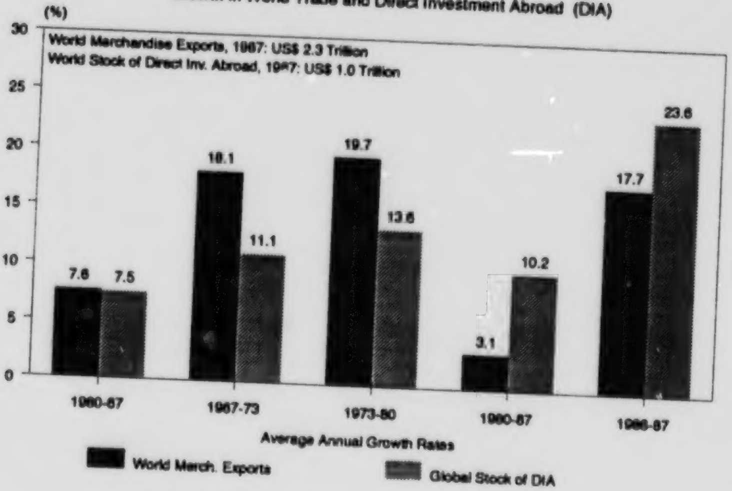
"Globalization" = integration of markets on a global scale

llustrations of Globalization:

- growth in world trade and foreign direct investment;
- increased openness of major economies;
- industrial rationalization world-wide;
- international networking and other forms of strategic alliances among firms;
- the growing importance of European and Asian markets

Figure 2

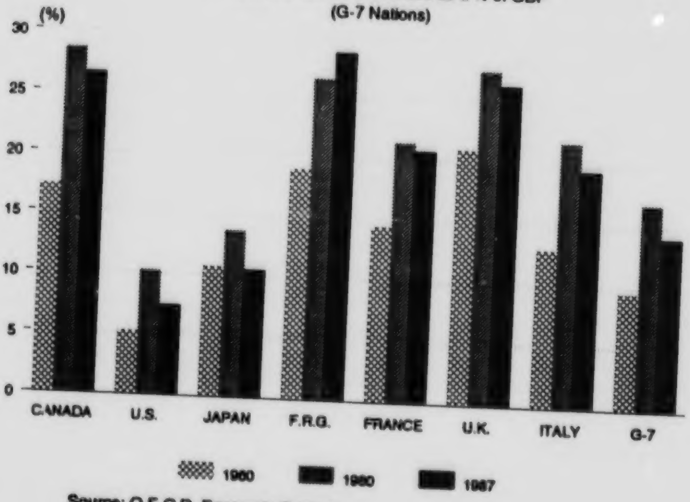
Aspects of Globalization:
Growth in World Trade and Direct Investment Abroad (DIA)



Source: U.S. Dept. of Commerce & Int. Monetary Fund.

Figure 3

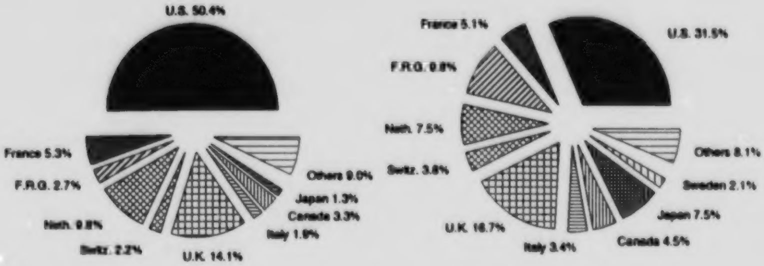
Aspects of Globalization:
Exports of Goods & Services as a % of GDP
(G-7 Nations)



Source: O.E.C.D. Economic Outlook

Figure 4

Aspects of Globalization:
World's Stock of Direct Investment Abroad
Distribution by Major Source Countries

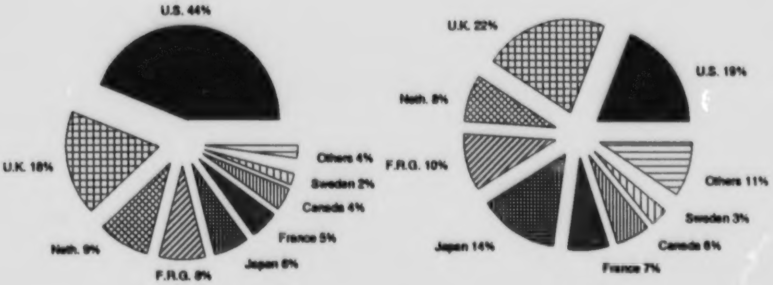


1967 Total = US$ 112.3 Billion **1987 Total = US$ 1.0 Trillion**

Source: U.S. Department of Commerce

Figure 5

Aspects of Globalization:
Share of Outward Direct Investment Flows
Major O.E.C.D. Countries



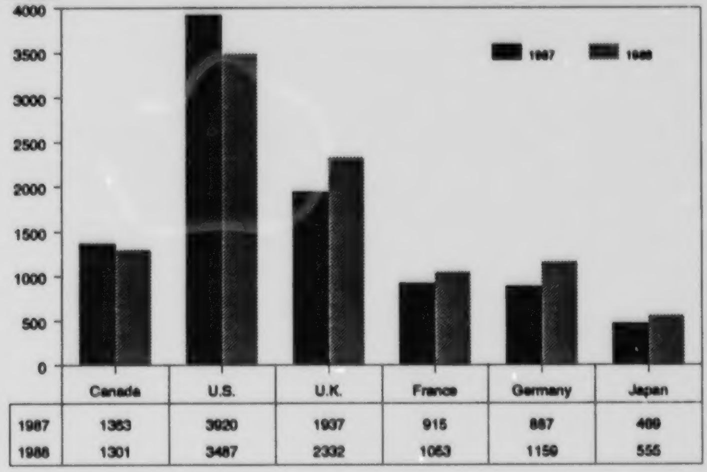
1971-180 **1981-1986**

(Cumulative Direct Investment Flows)

Source: Department of Economics & Statistics, O.E.C.D.

Figure 6

Aspects of Globalization:
Merger & Acquisition Activity in Selected Countries

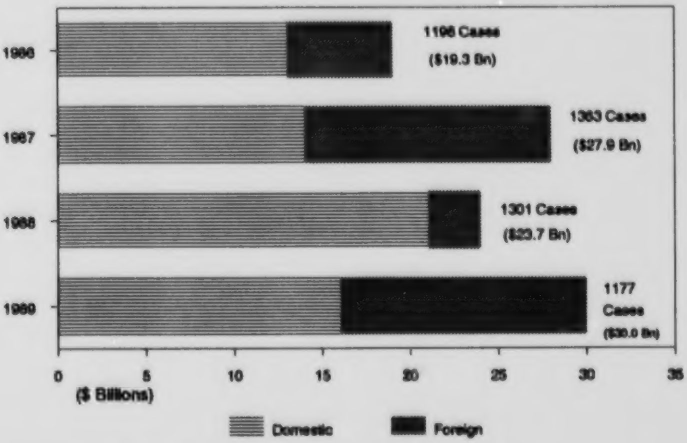


	Canada	U.S.	U.K.	France	Germany	Japan
1987	1363	3920	1937	915	887	489
1988	1301	3487	2332	1063	1159	555

Source: Mergers & Acquisitions, July/Aug., 1989

Figure 7

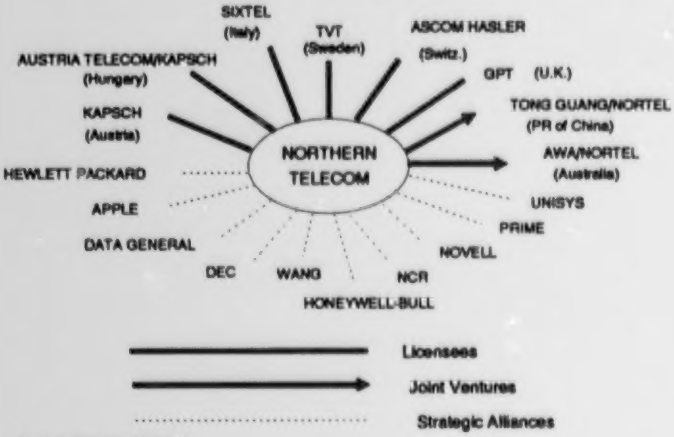
Aspects of Globalization:
Merger & Acquisition Activity in Canada
1986-1989



Source: Mergers and Acquisitions in Canada, 1990

Figure 8

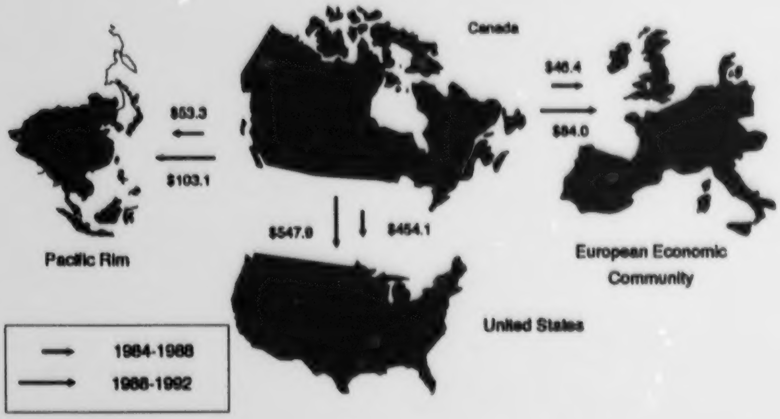
Aspects of Globalization:
An Illustration of International Networking
and Other Forms of Strategic Alliances


SIXTEL
(Italy)
TVT
(Sweden)
ASCOM HASLER
(Switz.)
AUSTRIA TELECOM/KAPSCH
(Hungary)
GPT (U.K.)
TONG GUANG/NORTEL
(PR of China)
KAPSCH
(Austria)
NORTHERN
TELECOM
AWA/NORTEL
(Australia)
HEWLETT PACKARD
APPLE
UNISYS
PRIME
DATA GENERAL
NOVELL
DEC
WANG
NCR
HONEYWELL-BULL
Licensees
Joint Ventures
Strategic Alliances

Source: Northern Telecom

Figure 9

Aspects of Globalization:
The Growing Importance of Asian & European Markets
Export Growth: In $ Billions


Canada
$40.4
$84.0
$53.3
$103.1
$547.9
$454.1
Pacific Rim
European Economic
Community
United States
1984-1988
1988-1992

Source: DRI

Muddling Through is not Enough: A Survey of Global and Domestic Economic Challenges

Murray G. Smith

Introduction

The dramatic events in Eastern Europe have captured public imagination and illustrate vividly the pace of change in the global economy. Less dramatic, but perhaps of more economic significance are the continuing dynamism of the Asia-Pacific economies, the remarkable liberalization of trade and investment that is underway in Mexico, and the revitalization of the economies of Western Europe as the Europe 1992 agenda transforms Europessimism into Europhoria. The implications of these international economic developments for Canada are shaped by domestic economic and policy constraints which influence the ability of the Canadian economy to respond to the emerging opportunities and competitive challenges. In turn, Canada's trade and investment policies emerge from the actions of, and interactions among, federal and provincial governments.

Part II of the paper examines the changing international economic context within which the Canadian economy is operating. Part III reviews the strategic trade and industrial policy literature and attempts to infer some policy recommendations of relevance to Canada. Part IV explores the interaction between the Uruguay Round agenda and Europe's 1992 program and the future evolution of the Canada-U.S. Free Trade Agreement. Part V then, considers the question of whether various trade and investment strategies pursued by federal and provincial governments in Canada are healthy competition or result in destructive fragmentation. Part VI draws some conclusions, and raises further questions about Canada's success or failure in managing integration to the global economy.

The International Economic Context

Several factors will influence the international environment within which the Canadian economy will be operating in the 1990s and beyond. One set of factors involves longer-term shifts in the secular currents of global trade and economic activity, including greater rivalry among the industrial countries and the emergence of the newly industrialized economies (NIEs), as well as the burgeoning importance of trade in services. A second set of factors involves developments in exchange rates which influence the tidal movements in global trade and services flows, and which will influence competitive opportunities for Canadian industries during the 1990s and into the twenty-first century. A third set of factors stem from geopolitical developments, which can have dramatic implications for flows of trade, capital and people.

EMERGING PATTERNS OF GLOBAL ECONOMIC COMPETITION

In the post-war period, the world has become much more interdependent and the balance of economic power has shifted. Europe and Japan have rebuilt their shattered economies and emerged as economic superpowers. A number of NIEs are becoming increasingly significant players in the global economy. The long-term trend towards greater economic interdependence is reflected in a steady shift of global economic activity towards the Pacific region.

Over decades the rapid economic growth rates of the Pacific economies and the resulting shifts in the global pattern of economic activity can have dramatic implications for national living standards. For example, in the early 1960s Ghana and South Korea had comparable per capita income and export levels. Today, Korea's exports exceed those of all the countries in sub-Saharan Africa (excluding South Africa).

Yet Canadians, including many business people, are preoccupied with competition from, and opportunities in, the large U.S. economy. Globalization has become a cliché, but like many clichés it points to a reality that comes to be obscured by familiarity. Many Canadians would claim to be aware of the economic dynamism of the Pacific region and of the imperatives of meeting global competition, but revert subconsciously to a view of the Canadian economy that is rooted in the 1950s, not the 1990s. As Eastern Europe attempts to stumble out of the Stalinist strait jacket, it is worth noting how much the rest of the world has changed.

Economic interdependence has increased for some reasons that are unrelated to economic policy. A long period of relative peace and security has fostered the expansion of global commerce. An ongoing revolution in the technology of transportation and communications has reduced, and continues to reduce, economic impediments to international trade in goods and services.

Economic policy cooperation among the industrial countries has contributed to increased interdependence as well. The reduction of tariffs and the liberalization of nontariff barriers, which has occurred under the auspices of the GATT and through regional trading arrangements, has made a significant contribution to the expansion of trade and economic growth in the last 40 years. In addition, and despite periodic stresses, strains and occasional crises in the exchange rate system, the International Monetary Fund (IMF) and other international financial institutions have facilitated the maintenance of an open trade and payments system. In conjunction with, and acting as major conduits for, increased international trade in goods and services, there is the rapid expansion of international direct investment. Trade flows are expanding more rapidly than domestic economies and direct investment flows are expanding more rapidly than trade flows.

In the early post-war period, the United States was the dominant economy in the world. In the halcyon days of the 1950s, major U.S. manufacturing industries, such as autos and steel, were largely impervious to offshore competition. These major industrial sectors enjoyed economies of scale in production in the U.S. market, which gave them a competitive advantage relative to producers in third countries. Perhaps more importantly for U.S. multinational firms (or firms that became multinationals in this period), their involvement in, and their exposure to, the large high-income U.S. market meant that U.S. firms were the first to develop and to introduce new products and techniques.

The situation was somewhat similar on the Canadian side of the border. As an exporter of resource products, Canada benefited from proximity to the prosperous U.S. economy and enjoyed a strong economic position relative to Europe or Japan. The Canadian market, although not as large as that of the United States, was substantial relative to other major industrial economies. For example, in the 1950s Canada was second only to the United States in the size of its domestic market for automobiles. During this period of booming resource exports, the Canadian tariff as well as the British Preferential Tariff played an important role in inducing U.S. manufacturing firms to set up subsidiaries in Central Canada, rather than exporting from production facilities in the United States. Canadian trade policies were often a source of regional differences in Canada, since the resource-based economies of western Canada and the Atlantic objected to paying higher prices to protect manufacturing employment in central Canada.

Today the world is very different. There has been a dramatic increase in global production and competition. Three factors account for much of this increase. First, competition has increased among the advanced high-income countries and there is growing global rivalry among multinational corporations. The most dramatic development is the emergence of Japan as the second largest national economy in the world. In the 1950s Japan accounted for about 2 percent of GDP in the industrialized countries, but the higher rate of economic growth in Japan as compared with other industrial economies has altered dramatically Japan's relative position. By 1985, Japan's share of GDP in the industrialized countries was 16 percent and will be about 20 percent in 1990.

The integration of the European market through the creation of the European Community (EC) and the European Free Trade Association (EFTA) and the subsequent linking of these markets through the EFTA-EC bilateral Free Trade agreements in the 1970s yielded a single market of 350 million people. Large domestic markets and the higher per capita incomes achieved both in Europe and in Japan, have enabled these economies to offer many of the potential advantages of economies of scale and innovation to their domestic firms. Thus, European and Japanese industry can now compete much more effectively against U.S. multinational enterprises in the development of new products and new technologies.

Second, high rates of economic growth among the group of NIEs have also altered relative competitive positions in international trade. Hong Kong and Singapore have enjoyed robust economic growth based on an outward-looking trade strategy. In conjunction with domestic policies that have shifted from an emphasis on import substitution towards a policy of export orientation, countries such as South Korea and Taiwan have become powerful competitors in the basic heavy manufacturing industries. As Table 1 indicates, each of these Asian NIEs has enjoyed higher rates of economic growth in the 1980s than Japan experienced in the 1960s and 1970s. The NIEs are a diverse group, with differences in their domestic policies, in their social and economic structures, and in their external trade and payments regimes, but several of them already have emerged as significant international competitors in industries such as automotive production, steel, and shipbuilding, which were traditionally the preserve of the industrialized countries.

Third, a group of countries consisting of developing economies with large populations are shifting from a heavy agricultural orientation towards more industrial production and trade. Economies such as Thailand, the Philippines, Malaysia, and until recently, even the People's Republic of China are following the path trod by Hong Kong and Taiwan, by pursuing more outward-looking policies and expanding their production and exports in labour-intensive, light-manufactured consumer products.

Table 1:
Growth of Production in Pacific Economies

Countries	Real Gross Domestic Product Average Annual Growth Rate (percent) 1965-80	1980-87	1988[2]
Developed Countries			
Australia[1]	4.2	3.2	3.0
Canada	5.0	2.9	4.5
Japan[1]	6.3	3.8	5.7
New Zealand[1]	2.5	2.9	0.4
Asian NIEs			
Hong Kong	8.6	5.8	8.1
Korea Rep.[1]	9.5	8.6	11.0
Taiwan[3]	8.5[4]	6.3[5]	7.1
ASEAN Countries			
Indonesia[1]	8.0	3.6	4.7
Malaysia[1]	7.4	4.5	7.9
Philippines[1]	5.9	-0.5	6.9
Singapore[1]	10.1	5.4	11.0
Thailand[1]	7.2	5.6	11.0
China, People's Rep. of	6.4	10.4	11.2
United States[1]	2.7	3.1	3.9

[1] GDP and its components are at purchaser values.
[2] Real GDP/GNP.
[3] Source: White Paper on International Trade, Japan 1988, Japan External Trade Organization.
[4] 1964-79
[5] 1980-85.

Sources: World Development Bank, Annual Report 1989. *Pacific Economic Outlook, 1989-90*; Pacific Economic Cooperation Conference.

The dynamism of the Japanese and East Asian economies has provoked major, largely defensive, responses in Europe. Although Europe is currently preoccupied with the "completion" of its economic union by 1992 and the developments in Eastern Europe, the 1992 agenda was stimulated by, and is a more constructive response to, Asian competition. Pacific governments are concerned about the extent of discrimination by the Community countries especially against East Asian manufactured exports. Although the Community's tariffs are not high, EC agricultural policies and nontariff barriers relating to textile products and consumer durables are notorious, and threats of antidumping duties based on questionable economic measurement are often used in order to obtain and to enforce voluntary export restraints.[1]

The dynamic growth of the Pacific economies has had significant implications for the patterns of Canadian bilateral trade. A decade ago, Western Europe accounted for 12 percent and the western Pacific 9 percent of Canadian exports, while as Table 2 indicates these shares were reversed by 1988. Similarly, British Columbia exports to the Pacific have grown from less than 30 percent in the late 1970s to almost 40 percent in 1988, and indeed, in 1989 B.C. exports to the Pacific surpassed exports to the United States.

Table 2
Canada's Merchandise Trade, 1988

	Percentages			
	Imports		Exports	
	Canada	B.C.	Canada	B.C.
U.S.A.	65.7	40.0	72.9	42.7
Pacific region[1]	13.9	48.5	12.4	38.2
Western Europe[2]	14.3	7.6	9.3	15.3
Other	6.1	3.9	5.4	3.8
Total	100.0	100.0	100.0	100.0

[1] Australia, Brunei, China, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand.
[2] EEC and EFTA.

Sources: Statistics Canada, Catalogues 65003, 65006

Three fundamental developments, which have profound implications for the Canadian economy, have also altered the competitive position of the U.S. economy. First, the advantages to U.S. producers from economies of scale in production and innovation have declined at the same time that improvements in the technology and infrastructure of transportation and communications have increased global competition. Since Canadian manufacturing is dominated by U.S. multinational enterprises, the decline in the relative position internationally of U.S. firms has important implications for Canada.

The growing interpenetration of trade and investment by multinational corporations poses particular challenges for Canada which has a heavy preponderance of U.S. subsidiaries. Many Canadians express concern about how U.S. subsidiaries will adjust to the Canada-U.S. Free Trade Agreement, when the real issue is how will the subsidiaries respond to global competition.

Canadian firms are poorly positioned to take advantage of emerging opportunities in the western Pacific or in Mexico. Canadian direct investment abroad is heavily concentrated in the United States and the United Kingdom, which account for 71 percent and 8 percent respectively. Thus, Canada's investment links to Europe are concentrated in the United Kingdom. Only Indonesia and Australia among western Pacific economies account for more than 1 percent of Canadian foreign direct investment.

Similarly, investment by Pacific economies in Canada is very limited. Together the United States and the United Kingdom account for over four-fifths of foreign direct investment in Canada, while Japan is the only Pacific economy represented among the ten largest foreign holdings in the Canadian economy. Although Japanese investment in Canada has grown very strongly in 1989 — up 93 percent as is indicated in Table 3 — the stock of Japanese direct investment in Canada is about U.S.$3.9 billion or about ⅓ the level of Japan's investment in Australia and 1/20 the investment in the United States. Overall Canada has attracted less than 2 percent of Japan's foreign direct investment. Among other Pacific economies, investment from Hong Kong and New Zealand has grown strongly in recent years, but the absolute amount remains modest. Of course, there are particular data problems with investment from Hong Kong that are associated directly or indirectly with immigration. As the Korean economy has matured it has begun to invest abroad. The stock of Korean investment in Canada is concentrated in a few projects, such as the Hyundai plant in Bromont, Quebec. The potential significance of such inward investment is illustrated by the fact that Hyundai is exporting cars assembled in Bromont to Taiwan. Since Canada is attracting about 8 percent of Korea's foreign investment, the stock of Korean investment could grow rapidly in future.

Table 3
Japanese Direct Investment Flows Abroad in billions of U.S. dollars

	Annual Flows			Semi-Annual Flows (Apr.-Sept.)		
	FY 1987	FY 1988	% change	FY 1988	FY 1989	% change
United States	14.70	21.70	+48	11.43	13.12	+15
% of Total	44.1	46.2		50.0	42.6	
Canada	0.65	0.63	-4	0.34	0.66	+93
% of Total	2.0	1.3		1.5	2.1	
Europe	6.58	9.12	+37	4.05	7.69	+90
% of Total	19.7	19.4		17.7	24.9	
Latin America	4.82	6.43	+33	2.86	2.76	-4
% of Total	14.4	13.7		12.5	8.9	
Australia	1.22	2.41	+229	1.11	2.26	+104
% of Total	3.7	5.1		4.8	7.3	
Asia (inc. M.E.)	4.93	5.83	+19	2.7	3.9	+46
% of Total	14.8	12.4		11.8	12.8	
Indonesia	0.54	0.59	+7	0.30	0.34	+11
% of Total	1.6	1.2		1.3	1.1	
Hong Kong	1.07	1.66	+59	0.73	0.94	+28
% of Total	3.2	3.5		3.2	3.0	
Total[1]	33.36	47.02	+43	22.86	30.82	+35

[1] The "Total" column does not correspond to the sum of JDIA for each country/region as some host nations of JDIA with insignificant inflows of Japanese investment have been omitted from the analysis.

Source: Japanese Ministry of Finance.

The second fundamental development is that the comparative advantage of the North American economies is changing as their share of specialized factor endowments, such as highly qualified manpower or modern technologically-advanced physical capital, are declining relative to the positions of the other high-income countries. This is most evident in the comparison with Japan where strong economic growth and high savings rates have been translated into high rates of investment in physical and human capital.

If Canada is not to experience further decline in its relative economic position when compared with either high income European countries within the sphere of the European Community, the emerging economic giant — Japan — or the dynamic newly industrializing economies of the Pacific Rim, then Canada must achieve higher productivity growth in the domestic economy and strengthen trade and investment links with the dynamic Pacific economies and a resurgent Europe. Canadian productivity growth has consistently ranked second last (ahead of the United States) in rankings among the industrial countries and lags far behind the productivity growth performance of the newly industrializing economies. (See Table 4 — International Comparisons of Economic Indicators, 1987.)

The third fundamental development is the unilateral steps by Mexico and the East European economies to liberalize trade and investment. Following on the steps of the Asian NIEs, the opening of these economies has both regional and global consequences. In the last five years Mexico has liberalized more than Canada has in the 55 years since the 1935 Canada-U.S. Trade Agreement. The nations of Eastern Europe, with their educated labour forces, low wage rates, proximity to the EC and, in some cases, past familiarity with capitalist industrialization, are viewed by some as attractive locations for foreign investments. Even if private sector investment in Eastern Europe proceeds cautiously, substantial resources are being committed by European governments and multilateral lending agencies.

The economic rationale for pursuing the Canada-U.S. Free Trade Agreement is to stimulate productivity gains and to enhance the competitiveness of the Canadian economy. Realizing some of these potential economic gains, however, will depend upon the ability of Canadian based firms — including foreign subsidiaries operating in Canada — to seize opportunities in third country markets, particularly in the Pacific, but also in Europe and Mexico. This conclusion is reinforced when macroeconomic factors are considered.

Table 4
International Comparisons of Economic Indicators (1987)

	United States	Canada	Japan	Germany	France	United Kingdom	Italy	South Korea
GDP ($ U.S. bil)	4497.2	373.7	2736.4	1117.8	873.4	575.7	748.6	122.3
GDP per capita ($ U.S.)	18530	15160	15760	14400	12790	10420	10350	2690
Exchange Rates*								
1980	1.0000	1.1693	266.70	1.8172	4.2261	0.4302	856.4	607.42
1987	1.0000	1.3259	144.60	1.7981	6.0121	0.6098	1297.0	822.57
GDP Average Real Growth Rate:								
1980-87	3.1%	2.9%	3.8%	1.6%	1.6%	2.6%	2.1%	8.6%
Unemployment Rate	6.2%	8.9%	2.8%	7.9%	10.5%	10.3%	11.0%	n.a.
Gross Domestic Investment (%GDP)	16	21	30	20	20	18	21	29
Gross Domestic Savings (%GDP)	13	22	34	25	20	18	21	38
Central Government Total Current Revenue (%GDP)	20.1	20.1	12.6	29.2	42.5	37.3	36.1	19.0
Central Government Overall Surplus (%GNP)	-3.3	-4.1	-4.9	-1.1	-0.8	-1.8	-16.5	0.5
Trade Balance (GNP)	-3.8	0.1	3.5	5.9	-1.6	-4.0	-0.7	5.1
Labour Productivity Trends Private Sector 1979-86[1]	0.6	1.1	2.8	2.0	2.3	1.9	1.3	n.a.
Output/hr[2] Manufacturing Sector 1987	100	70	78	87	69	41	68	n.a.
Compensation/hr[3] Manufacturing Sector 1987	100	89	83	126	92	67	92	13
Share of Youth Pop. Enrolled in Higher Education	57%	55%	30%	30%	30%	22%	26%	32%
Scientists and Engineers /1000 in Labour Force	65	30	62	49	41	34	27	n.a.
R&D Spending (%GNP)								
Total	2.83	1.38	2.81	2.66	2.31	2.33	1.33	n.a.
Defence	0.85	0.04	0.02	0.14	0.46	0.68	0.08	n.a.
Non-Defence	1.98	1.34	2.79	2.52	1.85	1.65	1.25	n.a.
Number of Leading Twenty Banks[4]	1	0	13	1	3	2	0	0

*National currencies against $U.S.; average of daily rates.

[1] Private sector, compound and annual growth rates; Labour productivity = real gross value added/ private sector employment, including self-employed.

[2] Gross production in manufacturing sector/ hours worked. Indexes calculated with a basis 100 for the U.S.

[3] Wages and fringe benefits per hour. Indexes calculated with a basis 100 for the U.S.

[4] *Wall Street Journal*, 23 September 1988 (based on net assets of 1987).

Sources: World Bank; OECD; U.S. Bureau of Labour Statistics.

SHIFTING TRADE TIDES

The sharp appreciation of the U.S. dollar in the mid-1980s and the substantial U.S. trade deficit that resulted has diverted Canadian trade flows and inhibited the private sector from expanding trade and investment links with Pacific and European economies. However, continuing pressures in financial markets resulting from the changes in national balance sheets will act to reverse the massive global trade imbalances of the 1980s during the 1990s. The realignment of exchange rates (which has sharply reduced the value of the U.S. dollar in terms of the yen and West German D-mark since 1985) has started the process of reversing global trade imbalances. However, the prospect for further short-term improvement in the U.S. trade balance is limited in light of the continuing U.S. budget deficit and the strength of the U.S. dollar in 1989 and early 1990. Yet the rapid build-up of U.S. international liabilities and the expanding U.S. deficit on investment income will put downward pressures on the U.S. dollar (the real exchange rate) through the 1990s.

The slow and irregular process of macroeconomic adjustment could make it harder to make progress in the Uruguay Round. Protectionism may be waning in the United States, albeit slowly, but the legacy of protectionist attitudes is likely to linger. As a result of the rebound of the U.S. dollar in 1989, the U.S. trade deficit may worsen in 1990-91, just as the Uruguay Round is coming to a conclusion. The U.S. Congress therefore may become increasingly belligerent. At the same time, Japan and Europe could become less willing to open their markets to competition from foreign agricultural producers and the manufacturing capabilities in developing countries if they anticipate that their currencies are likely to appreciate against North American currencies in the 1990s.

Similarly the pattern of Canadian trade is affected by the exchange rate alignment among the major industrial countries. During the 1970s when the U.S. dollar was low, Canada earned all of the trade surplus required to service its substantial international liabilities from offshore trade. During the 1980s with the strong U.S. dollar, Canada obtained all of the necessary trade surplus from trade with the United States and ran a trade deficit with the rest of the world. Although the process could be irregular, depending upon the budgetary policies that emerge from the continuing struggle between the U.S. administration and the Congress, during the 1990s the United States will be obliged by mounting foreign debt service requirements to continue to make progress in reducing its trade deficit. Thus, Canada will need to look to offshore markets for growing export opportunities.

The natural tendency for the U.S. trade deficit to be unwound during the 1990s could be reinforced by shifts in macroeconomic policy. Faced with the mounting costs of German unification, Germany is swinging from budget surplus to a significant budget deficit, which will lead to a contraction of

Germany's current account surplus. At the same time, Japan is increasing investment in infrastructure, which will tend to reduce Japan's trade and current account surpluses.

In addition to swings in global trade and payments flows, there will be renewed pressures for expansion of Canada's net exports of goods and services during the 1990s. In 1989, Canada had a current account deficit in excess of 3 percent of GNP reflecting the persistence of the fiscal deficit as the economy approached relatively high levels of capacity utilization. At the same time, Canadian monetary policy has been directed at containing inflationary pressures and has tightened in 1989, after the temporary easing immediately after the October 1987 stock market crash. This macroeconomic policy mix of large fiscal deficits and monetary restraint has led to a level of interest rates in Canada and an exchange rate for the Canadian dollar, which are high relative to sustainable values. With international liabilities in excess of $250 billion, the Canadian economy appears unable to sustain current account deficits at current levels. A sustained reduction in the fiscal deficit combined with an offsetting monetary expansion, which maintained a stable expansion in nominal income, would help accelerate the process. However, external macroeconomic pressures to moderate Canada's own external imbalance will be intense in the 1990s. Of course a new wave of expanding fiscal deficits (structural budget deficits adjusted for levels of capacity utilization) could delay this adjustment process, but this would only increase Canada's vulnerability as the largest per capita international debtor in the world.

Moving towards current account balance for the Canadian economy, at the same time that the U.S. economy is unwinding its large trade deficit, could lead to large swings in the pattern of Canadian trade. Canada will remain heavily dependent upon the U.S. market and achieving a higher share in that market may be the primary channel for the adjustment in Canadian trade flows through which an improvement in the current account balance could be effected. Nonetheless, large swings in trade with third countries also will be required. For example, achieving a one percentage point improvement in the current account deficit through offshore trade would require a 50 percent increase in exports to both Western Europe and the Pacific assuming no increase in imports from those regions. Since imports are likely to rise, achieving the necessary swing in net trade and current account balances will require an even greater expansion of exports.[2]

MEETING THE TRADE CHALLENGES?

Clearly the swings in trade flows that will be required to achieve a more sustainable current account position for the Canadian economy will require a dramatic shift in the marketing and product orientation of Canadian firms. The present private sector links with offshore markets and the public sector infrastructure that supports those private sector efforts will be tested severely in the 1990s. Indeed, the need for public sector support for trade promotion is most acute when firms are attempting to break into new geographic markets.

Canadian firms face particular challenges in breaking into the expanding markets in Pacific Rim countries. During the 1970s, when demand for resource commodities was expanding rapidly in Japan, Canadian exports across the Pacific expanded with only modest investment links — there were modest investments in resource developments by Japanese companies. The 1980s were a time of transition when demand for Canadian resource exports in the Pacific Rim economies lagged while the economies on the western Pacific built up large trade surpluses with the United States. During the 1990s trade flows and investment links among the western Pacific economies are likely to continue to expand. For example, manufactured products constitute an expanding share of Japanese imports, but the main sources of those products are other Asian economies. At the same time, Japan's exports to, and investments in, ASEAN countries now exceed those of the United States.

Similarly Canada faces challenges in Europe. Firms in Germany, Austria and other West European countries are well positioned to take advantage of emerging opportunities in Eastern Europe. Canadian trade and investment links with Western Europe have weakened during the 1980s and Canada's capabilities to participate in the economic restructuring occurring in the European Economic Space are limited.

The shifting pattern of trade flows and investment links among nations in the western Pacific and Europe will shape the opportunities and competitive challenges facing the private sector in all regions of Canada. The Ontario economy is the most closely linked to the United States and will face particular challenges and opportunities flowing from the liberalization of the Mexican economy, whether or not Canada participates in free trade negotiations between Mexico and the United States.

GEOPOLITICAL DEVELOPMENTS: ECONOMIC IMPLICATIONS

As the events of 1989 have demonstrated vividly, geopolitical developments can have dramatic implications for capital flows and trade. Although the outcomes are uncertain, "perestroika" and "glasnost diplomacy" of the Soviet Union and Eastern Europe as well as developments in China and the evolution of events leading to its reassumption of sovereignty over Hong Kong will have important economic implications. Less dramatic, but also significant, are the continuing tensions between the United States and Japan.

Developments in the Soviet Union and Eastern Europe will have significant effects on the economic dynamic in the "European Economic Space" and for the global trading system. In particular, German unification is influencing the EC 1992 agenda and creating difficulties for the agricultural negotiations in the Uruguay Round.

At the macroeconomic level, increased German government spending to meet the pressing needs of East Germans and the transfer of resources to Eastern Europe through the World Bank and the new European Bank for Reconstruction and Development (BERD) amount to a sizeable fiscal shock. Indeed, the increase in public spending in Europe associated with the Eastern European developments could be comparable in magnitude to the U.S. budget deficits in the 1980s, which had such dramatic effects upon exchange rates and trade flows.

If the Cold War is over in Europe, geopolitical developments are less auspicious in the Asia-Pacific region. Beginning in 1978 China embarked upon a reform of economic liberalization encompassing a process of economic decentralization, increased reliance on market forces, and an open-door policy with respect to foreign investment and trade. To many foreign businessmen, including Canadians, these policy changes heralded a period of vastly increased business opportunities with China, although it was generally recognized that fairly significant investments of time and resources were required. However, the events of June 1989 in Tiannemen Square, and the seemingly firm grip that the so-called "hardliners" have managed to establish on the levers of power in China, have led to a retrenchment in the area of economic policy. Although officials maintain that it is business as usual with respect to foreign investment and trade, the environment is not as conducive to business as it was before and it is unclear how this reversal in policy will affect Canadian business opportunities in the PRC.

At the same time, many businesses in Hong Kong worry that these trends in China bode ill for Hong Kong's future when China reasserts its sovereignty in 1997. The massive hemorrhaging of its human and financial capital is striking evidence of this concern and must be viewed as one of the most significant economic and political developments in recent years. The implications for Canada, and British Columbia in particular, are profound — a major increase in immigration and investment from Hong Kong. Canada is perhaps the country of preference for Hong Kong's fleeing talent and capital and, if as seems likely, Hong Kong's economy continues to be destabilized by concern over its future under the PRC, the flow of people and money to Canada will likely continue unabated. Cities such as Vancouver stand to gain significantly from this infusion of expertise (for it is the skilled workers who are emigrating) and money, but are challenged to implement the type of programs necessary to effectively integrate large numbers of immigrants into Canadian communities; failure to do so leads inevitably to the type of social tensions that can undermine the potential benefits.

The continuing tensions between the United States and Japan are another major source of uncertainty. In the worst possible case a cycle of retaliation under Super 301 could damage the multilateral trading system. The existing Super 301 legislation expires at the end of 1990 and the new Asia-Pacific Economic Cooperation dialogue established at the Canberra meeting in November 1989 could help contain serious transpacific ruptures as well as contribute to progress in the Uruguay Round. If the worst outcomes can be avoided, then continuing U.S.-Japan tensions over investment could create opportunities for Canada to attract more Japanese investment. The recent Keidanren report may signal some recognition of this potential in Japan. The report concludes:

> Japanese-Canadian ties cannot be isolated from the relationship that each of our countries has with the United States. We both view the U.S. as a major customer for our goods and services. Canada has consolidated this relationship by entering into the Free Trade Agreement (FTA) with the United States...The FTA will expand Canadian trade, attract American investment, and stimulate Canadian competitiveness. It will make Canada an even more attractive trade and investment partner for Japan. Not only will the Canadian economy be strengthened, but Canada's improved access to the U.S. market will be of particular interest to Japanese investors seeking to serve the entire North American market. At a time when some U.S. legislators are beginning to reassess their attitude toward foreign investment, Canada remains open and inviting. Under the FTA, foreign investors can take advantage of Canada's hospitable investment climate and its economic advantages while still enjoying access to the U.S. market.[3]

However, extreme Japan bashing and Super 301 could be expected to make a comeback on the U.S. legislative agenda if the Uruguay Round fails. If U.S.-Japan tensions escalate, then new stresses could come into play with respect to the Canada-U.S. Free Trade Agreement. Japanese companies who have been subject to harassment in Europe with restrictive rules of origin for "screwdriver operations" may worry that exports to the United States from Japanese subsidiaries in Canada may not qualify fully for the enhanced and more secure access under the Canada-U.S. FTA.

The future of international economic relations is thus an unpredictable mix of geopolitical, trade-based and macroeconomic factors. Economic interdependence is likely to increase and intensify whatever the outcome, but the adjustment to these pressures will not be easy and will come accompanied by numerous shock waves as Canada is forced to react to trends and initiatives originating beyond its borders.

Markets versus Intervention: Rhetoric, Theory and Practice

In retrospect the 1980s present some paradoxes. The rhetoric of the period was dominated by the so-called Reagan-Thatcher revolution, which stressed the superiority of market forces as the guiding principal for the economic activity. One paradox was that although the Reagan administration in the United States and the Thatcher government in the United Kingdom did deregulate and privatize some aspects of their respective domestic economies, the pattern of discretionary change in trade policies in the 1980s was towards the proliferation of trade restrictions and managed trade regimes previously confined to agriculture and textiles into sectors such as automobiles, steel and increasingly also in high technology products such as semiconductors.

A second paradox is that the steady growth performance of the major industrial countries and the dynamism of the NIEs — particularly when compared with the stagnant Soviet and East-European economies — stimulated perestroika. Yet the economic dynamism of the Asia-Pacific economies has received a defensive protectionist response in Europe and North America. Although perestroika has been hailed as the triumph of market capitalism, to date little restructuring of the price and allocation mechanisms of the Soviet and East-European economies has actually occurred. Perhaps perestroika is another example of the parable of the prodigal son referred to in the Bible. At the present time the United States has very positive political and economic relations with the Soviet and East-European economies. Yet at the same time, the United States is in the midst of very severe trade frictions and disputes with Japan and some of the other newly industrializing economies in the Asia-Pacific region. The Asia-Pacific economies have been practising market-oriented perestroika policies for decades, but the competitive challenges they pose in the domestic markets of the European and North-American economies are eliciting a response which can at best be described as ambivalent.

A third paradox is that the shift towards outward looking economic policies among the east-bloc economies as well as a few developing economies has occurred at the same time that the academic literature in economics has been exploring the scope for strategic trade and industrial policy interventions.[4] The models examined in this literature modify the conventional international trade theory which is based on models of competitive industrial structures by incorporating economies of scale or scope in production, which give rise to oligopolistic or monopolistic competition industrial structures. Various strands of this literature derive optimum tariff or subsidy policies by home governments which enable them to collude with domestic firms in order to improve economic welfare of the home country at the expense of foreign companies and governments.

STRATEGIC TRADE AND INDUSTRIAL POLICIES: THEORY

Much, but by no means all, of the theoretical literature on strategic trade and industrial policies is developed from the point of view of a large country. There are several caveats that apply to this strategic trade and industrial policy literature. First, as Eaton and Grossman have observed, the subsidy or tariff policies that are optimal under one set of hypothesized assumptions are not robust with respect to alternative plausible assumptions about the behavioural responses of firms in imperfectly competitive markets.[5] Second, there is a problem that arises from the incentives for firms to invest in lobbying activity in order to manipulate strategic trade and industrial policies. Thus, in practice governments might implement policies that deviate substantially from the hypothetical optimal tariff and subsidy measures. Moreover, firms may waste resources through over-investing in the lobbying process.[6] Third, the models ignore potential retaliation by foreign governments or even the possibility that foreign governments will engage in similar practices.

A different problem that arises in democracies is the public and political reaction to the proposed optimal policy interventions. In many instances, if governments could identify the optimal policy interventions, the results would almost invariably be to transfer substantial resources to very high income individuals or very successful enterprises. Thus, the "correct" strategic trade and industrial policies may offend equity criteria in the domestic body politic.

It must be noted that in most of the models analyzing strategic trade and industrial policies, the home country and the home firm collude to obtain economic benefits at the expense of the trading partner, which is presumed to be a small exporter. The impact on the foreign country of these types of trade interventions is unambiguously negative. Thus, it is not surprising that existing GATT rules limit the use of tariffs or prohibit export subsidies in the industrial sector.

GAINS FROM TRADE REVISITED

The strategic trade and industrial policy literature is part of a much broader synthesis of international trade theory that was developed primarily on the basis of competitive industrial structures experiencing constant returns to scale, and the new industrial organization theories that stress product differentiation in oligopolistic- or monopolistic-competition industrial structures. Although the synthesis of industrial organization and international trade theory is much less complete theoretically than many recognize, the new approaches provide an explanation for the vast expansion of intra-industry trade and also of intra-industry investment among the industrial countries in recent decades.[7] In this new framework, the multinational enterprise provides an effective mechanism for the international transmission of technology. Competition in markets for goods and services is created by the mutual interpenetration of industrial country markets by multinational enterprises.

Although most of the theoretical contributions to the policy analysis stemming from the strategic trade and industrial policy approaches focus on specific trade or subsidy interventions, the introduction of economies of scale and product differentiation vastly increases the gains from trade liberalization. Empirical work by Max Corden and Harry Johnson in the 1950s and early 1960s indicated that the gains from lowering the trade barriers then remaining among the industrial countries were relatively modest as a proportion of GDP. If industries were characterized by constant returns to scale and competitive industrial structures, their results indicated that the cost of the tariff was in the order of 1 percent of GNP. The pioneering work by the Wonnacotts indicated that with economies of scale in manufacturing industries, the gains to Canada from free trade with the United States would be much larger, ranging up to 10 percent of GNP.[8] Similarly, the Harris-Cox analysis of Canada-U.S. free trade in the 1980s and the Cecchini analysis of completing the internal market in the European Community obtained substantial gains from trade liberalization because of the assumptions of economies of scale and product differentiation as well as pro-competitive responses by oligopolistic industries.[9] The study prepared by the Department of Finance to evaluate the impact of the Canada-U.S. FTA obtained an estimate of 2½ percent of GNP, which is much lower than the Harris-Cox estimates, in large part because of their more conservative assumptions about the potential realization of economies of scale.

It must be noted that the economies of scale gains analyzed by the Wonnacotts and Harris-Cox are economies of scale that are internal to firms. Thus, the consequences of trade liberalization, both from reducing domestic trade barriers and obtaining better access to foreign markets, are to induce rationalization of the domestic industrial structure and enhance productivity.

In addition to economies of scale internal to firms, there are potential dynamic gains from trade that result from economies of scale external to firms. Since these external gains are difficult, if not impossible to measure, they are frequently ignored or neglected in policy analysis. The sources of these external economies of scale derive from such factors as the development of skilled human capital with specialized expertise and the enhancement of technology, which is diffused among firms in an industry and across industries throughout the economy.[10] Moreover, open and outward-looking trade and payments regimes enhance the effectiveness of the allocation of scarce investment capital, reduce the incentives for investment of entrepreneurial talent and capital in rent-seeking and lobbying activities, and by stimulating investment and competition may stimulate innovation, adaptation, and diffusion of technology throughout the economy. Although he does not explicitly stress these dynamic gains from trade external to the firm, Michael Porter, in his new book *The Competitive Advantage of Nations*, stresses the role of domestic competition in promoting a competitive and dynamic manufacturing centre.[11]

There is a lack of good empirical analysis of these potential dynamic gains from trade which are external to individual firms. However, these types of gains may explain the dramatic differences in economic growth performance that have been exhibited by countries that in the recent past have had relatively similar social structures and factor endowments but have pursued different trade strategies. For example, if one looks at country pairs such as Thailand and Burma, North and South Korea and even Kenya and Tanzania, there are evident dramatic differences in economic growth performance which it seems doubtful can be explained by simply adding the economic welfare triangles measuring the static costs of the tariff. Of course, any examples of such comparative analysis between countries in their economic performance invariably raises debateable questions because it is impossible to isolate a broad range of social, economic, and resource endowment factors that create national differences and undermine the precision of such a comparison.

Even if one cannot ever satisfactorily resolve all of the analytical and empirical questions to obtain precise careful measures of the dynamic gains from outward looking trade and payments regimes, the dramatic performance of Japan and the newly industrializing economies in the Asia-Pacific region and the sentiment, if not the reality, of perestroika reflect the compelling significance of these potential dynamic gains.

GLOBALIZATION AND HARMONIZATION

Many concerns were expressed by Canadians during the free trade debate that the longer-term consequence of free trade with the United States would be to oblige Canada to harmonize its tax, social and economic policies with those of the United States. The concern about harmonization may have validity in the context of growing global economic interdependence, or globalization, but is incorrect in the specific context of the impact of the Canada-U.S. FTA. This issue warrants several observations.

First, even within federal nation-states, economic pressures for policy harmonization are not overwhelming. Significant divergence in taxes, regulatory policies, labour legislation and environmental standards exist within Canada and United States. Despite the relative openness of markets for goods and services — in most instances — and the mobility of labour and capital within these federal systems, provinces and states differ substantially in their tax, regulatory, and social policies.

Second, in an international context, the economic pressures for policy harmonization, which operate internally within a federal country, are greatly reduced by two factors. First, balance of payments and exchange rate adjustments over time offset the effects on industrial location and trade that are associated with differences in broad-based tax or social policies. Moreover, the mobility of factors, capital and labour, across international boundaries may exert greater pressure for policy harmonization than does expanded trade in goods and services. The East German government recognized these pressures 30 years ago with the erection of the Berlin Wall to stem the growing tide of emigration to West Germany. The pool of potential emigrants built up behind this dam and eventually started to flood out through Czechoslovakia, Hungary and other east-bloc economies to West Germany in 1989. Eventually, this tide of emigrants washed away the Berlin wall and the East German Communist regime. In the Canada-U.S. context such dramatic pressures are not evident, but the mobility of highly skilled and educated workers across the 49th parallel puts pressure on governments to harmonize marginal income tax rates. Similarly, it becomes difficult to tax corporations at significantly different rates in competing jurisdictions.[12] Nonetheless, far from reducing taxes after free trade, federal and provincial governments in Canada have increased taxes subsequent to the implementation of the Canada-U.S. Free Trade Agreement.

Indeed as economists have argued, expanded trade between Canada and the United States may reduce international pressures for policy harmonization because the economic benefits from trade can be used to finance public expenditures or to permit higher standards of environmental regulation. Furthermore, increased profit and employment opportunities obtained through greater specialization may serve to reduce incentives to the highly skilled or to mobile multinational firms to emigrate that might be associated with differing marginal income or corporate tax rates.[13]

At the simplest level, the issue of harmonization of tax and economic policies or indeed of wage levels can be illustrated by concerns frequently expressed in Canada that with free trade, Canadian manufacturing industries would be unable to compete with low wage labour in Tennessee. This concern ignores the fact that real wage levels in New England, the U.S. mid-west or the Pacific north west are higher than in the comparable cross border regions of Canada, yet those regions of the United States are able to continue to sustain their economic viability despite open trade and factor flows within the United States. In any event, the real challenge for competition with low wage manufacturing does not come from Tennessee, it comes from Taiwan, Thailand, Mexico and the People's Republic of China (if the People's Republic continues or maintains even modestly outward looking policies), and perhaps now from Eastern

Europe. The issue for Canada is whether like the East German government, which sought to restrict evermore forcibly external economic pressures through restrictions on emigration, Canada will pursue discriminatory restrictive trade regimes in sectors vulnerable to imports from low wage developing countries. To a considerable degree, the Multifibre Arrangement (MFA) has been such an arrangement intended to insulate the Canadian economy — and also the economies of the other industrial countries — from the exports of low wage economies in an industry that is labour intensive and internationally mobile requiring relatively limited investment and utilizing basic technology and management skills.

Of course, the issue of policy harmonization can also be construed as an issue of locational competition among different jurisdictions. For example, we can consider Tiebout-style competition among two suburbs in a large metropolitan area.[14] One suburb may impose high property taxes on residents and in return offer high levels of services and amenities such as frequent garbage collection, clean sidewalks and public parks. Another suburb might offer low tax rates but provide few services leaving residents to transport their own garbage to the community dump, and foregoing sidewalks and other public amenities. Democratic values suggest that citizens should be free to choose which of these options is appropriate to their personal preferences. Of course, citizens living in either suburb can engage in political activity within their jurisdiction that might lead either suburb to adjust its policies either towards lower taxes and lower levels of service in the former jurisdiction or towards higher taxes and higher level of services in the latter jurisdiction.

The issue of such Tiebout-style locational competition becomes much more complicated when the communities are not suburbs of a metropolitan area within a nation-state where citizens are highly mobile, but are separate nation-states or even subnational jurisdictions in different nation-states. One can easily imagine import-competing interests in the low-tax, low-service economy launching countervailing duty actions against the alleged subsidies provided to industries in the high-tax, high-service economy, such as waste abatement, infrastructure development and other services in kind, which the competitors in the other jurisdiction perceive as being provided free by the government. At the same time, import-competing interests in the high-tax, high-level of service jurisdiction may express concern that imports coming from the laissez-faire jurisdiction are not meeting the same environmental standards or the obligations with respect to labour standards that they are obliged to meet in the high-tax, high-amenity jurisdiction. These are issues that are not easily resolved, and they are issues that are likely to remain on the international trade agenda for some years to come.

Leaving aside for the moment the debate about which government policies create an unfair trade advantage, competition in amenity levels among subnational jurisdictions may become an increasingly important feature of economic integration. Good schools, efficient public transit, modern airports and desirable urban environments are important factors influencing location decisions by highly skilled individuals and firms.

In Canada, the federal system of government will shape the ability of Canadian governments to compete internationally in amenity levels. In recent decades, Canada has developed an elaborate system of equalization and federal-provincial cost-sharing programs in order to provide greater balance in the levels of public services and infrastructure available in various parts of Canada. Various aspects of this fiscal federalism will be subject to growing stresses in the 1990s due to the mounting level of federal debt and expanding debt service obligations.

FRAMEWORK POLICIES VERSUS SECTORAL POLICIES: IMPLICATIONS FOR CANADA

The debate about strategic trade and industrial policies is a debate both about theory and facts. To paraphrase Goethe, everyone who has a theory has a fact. Some observers look at Japan, South Korea and Thailand and argue that selective trade restrictions dramatically enhanced their economic growth. Others argue that the high savings rates, low tax burden, flexible labour markets and emphasis on education were the engines of their dynamic growth.

There is the problem raised by Laurent Picard in his supplementary note to the report of the Royal Commission on Canada's Economic Union and Development Prospects, which was chaired by the Hon. Donald Macdonald. Picard makes the point that even if a homogeneous society and economy like Japan can usefully utilize industrial targeting as a way to stimulate economic growth and productivity enhancement — and Picard appears sympathetic to this proposition — will Canada with its federal-provincial division of powers and the regional dispersion of cities and economic activity be able to sustain a viable industrial targeting policy?

Framework Policies

Almost all government policies have some influence on trade and investment and thus influence the pattern of economic growth. The broad horizontal policy issues involve mobilizing human resources effectively, fostering the development and diffusion of technology, mobilizing savings and allocating risk capital, and designing national policies that will facilitate the effective utilization of natural and environmental resources. There is considerable interaction among federal and provincial governments in Canada in the design and implementation of such framework policies.

Mobilizing Human Resources

Policies influencing labour markets and the operation of the education system are among the most contentious in any industrial society and Canada is no exception to this rule. In tackling these difficult economic, political, and social issues, two priorities stand out.

First, it is important to improve the quality and effectiveness of all aspects of the education system. Canadian high school students rank low on international test scores for sciences and mathematics. Lack of these skills must be a concern in an increasingly technological world. Beyond technological competence, a well educated labour force is more flexible and can adapt more easily to a changing global economy.

Second, it is important to provide incentives and assistance measures that will facilitate the redeployment of the labour force as new economic opportunities emerge. Such policies would include: portable pensions; tax-free severance payments; and increased resources for retraining in conjunction with reform of the Unemployment Insurance system.[15]

Fiscal and Monetary Policy

Fiscal and monetary policy set the background against which private-sector activity creates wealth and income. In setting its monetary policy the Bank of Canada has a stated policy to its goal of maintaining a low inflation rate and seeking to attain a zero-inflation rate. This is not the place to debate whether a zero-inflation rate or a low stable inflation rate of say 3 percent should be the current medium-term goal of Canadian monetary policy.[16] However, it is clear that inflation has long-term harmful effects on the economy. For example, high and variable inflation rates affect savings and investment decisions and influence wage and price setting. It is noteworthy that economies such as Japan and Switzerland, which have low and stable inflation rates, also have low unemployment rates and good economic growth records.

With regard to fiscal policy, at almost 5 percent of GNP the Canadian federal budget deficit must be a prime concern. This is not the place to argue the exact timing, but many economists will agree that getting the deficit under control is the key objective of medium-term fiscal policy. Interest payments already take up almost 40 percent of total federal government revenues. This leaves too little room for other government spending initiatives and creates the fear that, sooner or later, large deficits will be monetized and thus be inflationary. Steady sustained reductions in the Canadian federal budget deficit ought to give the Bank of Canada more flexibility in pursuing non-inflationary monetary policy while permitting the real effective exchange rate to adjust downward reflecting the reality of Canada's foreign debt, which is currently in excess of 40 percent of GNP, and Canada's current account deficit of 3 percent of GNP.

Sustained reductions in the federal budget deficit — which are not offset by increases in provincial deficits — in conjunction with monetary policies aimed at sustaining stable growth in nominal GNP will lead to dramatic changes in Canada's current account balance. Clearly, significant changes in the real effective trade weighted exchange rate of the Canadian dollar would be necessary. Swinging Canada's current account towards balance requires creating a surplus on trade in goods and services in excess of 5 percent of GNP.

Tax Policy

The tax system influences the allocation of resources and the mobilization of savings, as well as influencing location decisions for corporations making new investments or the highly skilled seeking new opportunities. Pressures for reform of the manufacturing sales tax are strong in light of administrative problems and economic distortions that it creates, but the Goods and Services Tax is very unpopular. Ideally, an integrated federal-provincial approach to consumption taxes would be implemented, but this is likely to be at least as difficult to achieve as constitutional change. It is evident, however, that Canadian governments impose relatively high marginal personal and corporate income tax rates and are beginning to encounter diminishing returns because of potential emigration of highly-skilled individuals and corporate investment.

DESIGNING NATIONAL COMPETITIVENESS POLICIES

One of the most important conditions for creating a dynamic, growing economy is reaching agreement on the appropriate economic strategy. We can distinguish three basic positions with respect to such a strategy. At one extreme is the "no-action-needed" laissez-faire approach, according to which the government needs to do nothing whatsoever. Economic growth and development can be left fully in the hands of the private sector, which, as long as the government does not discourage it, needs nothing from the government by way of encouragement. At the other extreme lies the "microintervention" approach, where the government identifies winners and backs them with a host of favourable policies, including subsidized research and development, low-interest loans, favourable tax treatment, and relevant skills-training schemes. In between these two extremes is the "macroclimate" approach. In this view, the government creates a climate that is favourable to invention and innovation and then leaves it to the private sector to decide what risks are worth taking and where the funds for invention and innovation should be channelled.

Fostering Technology

Canadian spending on research and development is low relative to other major industrial countries. Another key human resource policy, which complements technology policy, is support for a world-class university system. All too often, policy-makers emphasize business research and development while forgetting universities, which are the basic source of discovery and invention. "High-tech" industries in the United States, for example, have tended to locate near some of the country's best universities because these can be relied on to provide the necessary supplies both of basic ideas and of highly trained people as well as interaction with researchers. According to OECD data, Canada has only 30 researchers per 10,000 members of the labour force, compared with 43 in Germany, 52 in France, 65 in the United States and 79 in Japan. (See Table 4.)

Other industrial countries are engaged in intensive rivalry in the development of high technology capabilities. The challenge for Canadian federal and provincial governments is to find an effective basis for allocating scarce resources to support technology development. In particular, with serious fiscal constraints, governments will face difficult decisions about which types of research ought to be funded.

Canadian governments have been willing to offer substantial tax incentives, subsidies and other forms of assistance for high-technology industries and to promote research and development. At the same time, Canada has provided very limited protection for intellectual property in areas such as pharmaceutical patents. Perhaps more significant Canada has moved slowly to update intellectual property laws to provide copyright protection for computer programs and new *sui generis* forms of protection, such as the registration of chip typographies. Updating Canada's intellectual property regime in the context of the Uruguay Round TRIPs negotiations could prove to be a very cost-effective way to stimulate research and development and to foster innovation.[17]

Trade Policy

In the longer term, the global competitive challenges confronting both the United States and Canada make their respective interests in implementing the Free Trade Agreement more compatible. Each country stands to benefit from the rationalization of U.S. and Canadian multinational enterprises that operate on both sides of the border. Furthermore, much of the adjustment to freer bilateral trade will be intra-industry. Thus, adjustment costs will be minimized, while the opportunities for specialization will be significant. Elimination of tariff and many nontariff barriers between Canada and the United States under the Canada-U.S. Free Trade Agreement will increase the scope for product specialization and enhance the returns from successful innovation. As a result, the Canadian firms — and U.S. subsidiaries in Canada — will become more competitive with offshore rivals as the Canada-U.S. Free Trade Agreement is implemented. Yet reaping all of the benefits to be derived by Canadian industries from rationalization in the North American market depends upon obtaining better terms of access to offshore markets. The Uruguay Round is the best available vehicle to improve access to such offshore markets.

CONCLUDING OBSERVATIONS

At root, the competitiveness problem for Canadian policy-makers is to focus more on the implications of today's policies for the real living standards of future generations. Most of the policy decisions that Canadians must make are questions of domestic economic policy. Canadians must decide whether, and how, to reduce budget deficits. Canadians must decide how to improve the effectiveness of our education system and to facilitate redeployment of the labour force. Canadians must decide how to stimulate the ability of our economy to develop and to assimilate technology. Canadians must decide how to design their tax system to balance equity and efficiency objectives.

Yet as a middle-sized economy, Canadian choices on these issues must take account of the global economic context. Intense technological rivalry among the United States, Japan and Europe combined with the shift towards outward-looking trade and investment policies in Mexico and now in Eastern Europe, — following the path trade by the Asian NIEs — shape the challenges confronting the Canadian economy. At the same time, Canadian governments and citizens must recognize that domestic policies shape the climate for foreign investment and domestic enterprise. For it is the private sector that must cope with the evolving international trading environment. Whatever the outcome of the Uruguay Round of GATT negotiations, Canadians will face intense economic challenges. However, progress in resolving international differences through multilateral negotiations could facilitate the resolution of domestic differences within Canada. It is to this more focused set of international trade policy challenges that we now turn.

The International Agenda

Clearly, the negotiating agenda for the Uruguay Round of GATT negotiations is the most significant set of commercial negotiations now confronting Canada. Rather than reviewing the whole Uruguay Round agenda, the issues bearing on federal-provincial relations can be best illustrated by examining the interaction between the Uruguay Round agenda and the agendas for Europe 1992 and the evolution of the Canada-U.S. Free Trade Agreement.[18] Before turning to these issues, however, one observation is in order.

Tariffs still matter in Canada's trade with countries other than the United States.[19] The escalation of tariffs on processed resource products still is a significant barrier to diversification of exports to offshore markets, particularly in the context of the European Community's various bilateral trade relationships with other countries. For example, Canada is the only substantial MFN supplier of paper products to the European Community. Virtually all of the other suppliers are either in Scandinavia or members of the Lomé Convention. As a result, the negotiations of market access in the Uruguay Round could have very important implications on Canadian exports to Europe. Of course, Canada having just negotiated a FTA with the United States, is gradually implementing tariff preferences for suppliers based in the United States which will have implications for the competitive position of EC, Japanese, or other third-country exports in the Canadian market. This provides a very useful basis for Canadian negotiations of market access in the Uruguay Round.

THE URUGUAY ROUND AND THE EUROPE 1992 AGENDAS

There has been considerable uncertainty about the commercial implications for third countries of the Europe 1992 agenda. If we examine the 1992 agenda to identify issues that may have added adverse impacts on trade with third countries, we find that those issues are concentrated in agriculture, technical barriers, safeguards and antidumping duties, rules of origin, public procurement and services. Those are the areas where the third-country dimensions of the 1992 agenda loom large and those are areas where the existing GATT rules are either inadequate, incomplete or non-existent. Thus, the outcome of the Uruguay Round could be very significant in terms of dealing with potential external consequences of Europe's 1992 agenda and the emerging links between Western and Eastern Europe.

Three specific issues arising from the interaction of the Uruguay Round and the Europe 1992 must be mentioned with respect to Canada. First, and perhaps most complicated, is the issue of agricultural policies and trade. The key issues in the agricultural negotiations remain unresolved and thus the potential implications for Canada are difficult to assess with precision. If only a minimal result is achieved in the Uruguay Round, then there is a significant risk that the East European economies will be drawn into the ambit of the Common Agricultural Policy. If, however, significant restraints on EC internal support and export subsidies combined with ceiling bindings and tariff-rate quotas imposed on the variable levies, then there are real possibilities for controlling the destructive international subsidy war in agriculture.

Meaningful progress on the agricultural negotiations will be difficult to achieve. The immediate challenge for Canada and the United States is the need to negotiate agreements and disciplines on agricultural subsidies and quantitative import restrictions in the multilateral GATT negotiations. Both countries are pushing for major reforms in farm and trade policies in the GATT Uruguay Round scheduled to conclude this year. This will require a willingness to reduce or remove subsidies and border measures that limit or distort trade. For example, the United States will have to relinquish its agricultural waiver that gives it *carte blanche* to impose import quotas to protect programs of farm support. Canada will have to accept less protection and more competition for its supply managed commodities. For its part, the European Community must agree to discipline its system of variable import levies and export subsidies and lower farm supports. All European countries and Japan must open up their systems to allow more agricultural trade. And all of these countries must agree to stronger trade rules for agriculture that apply equally and can be enforced. These must include disciplines on the use of subsidies that affect farm trade. As a substantial exporter of agricultural products, Canada has much at stake in the agricultural negotiations, but participation in commitments to reduce domestic subsidies will pose challenges for Canadian governments. At a minimum, under such arrangements, federal governments of Canada and the United States will be obliged to take account of provincial and state agricultural subsidies in meeting national commitments. Moreover, specific obligations regarding the practices of provinces and states may well be required.

Second is the issue of antidumping duties which the European Community has tended to apply, or threatened to apply, in order to obtain Voluntary Export Restraints (VERs) on Asian exports. It would appear to be only a matter of time before the EC takes antidumping actions against Japanese automobiles assembled in Canada. With the significant expansion of automotive assembly capacity in North America and a slow-down in automotive sales, exports to Europe from Japanese or Korean subsidiaries could become significant. Indeed, Honda has indicated already that it plans to export to Europe automobiles assembled in Canada. Yet as Brian Hindley has argued, the EC antidumping laws provide a convenient relief mechanism that could act as a palliative to ease internal pressures arising from the dismantling of member state quotas and VERs on automobiles and the related regulations within the Community which enforce these member state restraints.[20] The administration of these trade restrictions also raises serious rules-of-origin issues. Thus, antidumping issues are likely to become an important bilateral issue between Canada and the European Community, just as the antidumping and countervailing duty laws became important bilateral issues between Canada and the United States.

Third is the issue of procurement policies in the EC, which are very important in bilateral trade in sectors such as telecommunications equipment. Liberalization of government procurement is an important element of the Europe 1992 agenda. If much of EC member state procurement is brought under the GATT procurement code, then the opportunity is there for Canadian-based firms to expand trade in such procurement-intensive products, if Canada is prepared to participate for comparable types of entities. Such Canadian participation will raise the issue of bringing provincial procurement practices under the obligations of the GATT agreement. Yet, if Canada cannot participate in such an expanded procurement arrangement, then "Fortress Europe" could become a disturbing reality.

THE CANADA-U.S. FTA CONTINUING AGENDA

The most contentious issue on the continuing agenda for the Canada-U.S. FTA is the development of rules for subsidies, countervailing and antidumping duties. The globalization of trade and investment through multinationals makes antidumping and countervailing duties increasingly byzantine and bizarre in their application. It does not follow, however, that legislatures or governments in their negotiating approaches during the Uruguay Round will reflect this long-term consequence. Indeed, Congressional attitudes, and hence the U.S. negotiating position, seem shaped by the last war — the large 1980s trade deficits — and seem unaware that the United States will need to service its mounting international liabilities in the 1990s.

Developing mutually agreed rules about which subsidies have "harmful effects on trade" will not be easy in either the ongoing Uruguay Round of GATT negotiations or in prospective bilateral negotiations mandated under the FTA. Clearly, such rules could raise significant issues for the policies and practices of subnational governments in Canada and the United States.

The specificity issue has become contentious because under U.S. (and also Canadian) trade law it is the only factor that determines which domestic subsidies are subject to countervailing duties and which are not subject to countervailing duties. What is required is a clearer set of international rules about which subsidies "have harmful effects on trade." For example, subsidies to the primary fishing industry may maintain employment in particular communities, but have no effect on trade because the harvest is controlled by quotas. On the other hand, assistance to processing or manufacturing industries may transfer production and employment across international boundaries.

The full implementation of the Canada-U.S. FTA for agriculture must await the outcome of the Uruguay Round. Should this key multilateral negotiation fail, the two governments face a challenge to tackle these problems between themselves. Even if the Uruguay Round achieves a lot in developing clearer international trade rules and in reducing agricultural subsidies, there is likely to be unfinished business between Canada and the United States with respect to farm subsidies.

Interesting issues are raised for provinces and states by proposals that have been made in the Uruguay Round GATT negotiations. For example, the European Community has pointed out an anomaly in existing rules regarding specificity. If a state or province offers a development assistance program across its whole jurisdiction the program would not be countervailable, but if the federal government were to provide the same program to a group of states or provinces the program would be actionable under countervailing duty laws. Yet if state or provincial programs are countervailable simply because not all states or provinces offer an identical program then many existing state and provincial programs potentially would be subject to countervailing duties.

The United States has proposed in the GATT that resource rights that are not auctioned should be regarded as a countervailable subsidy. This is the stumpage issue cast in more general terms, but it raises interesting questions for the allocation of hard rock mining rights in both countries, because the tradition of the prospector staking a claim is the method of allocating these rights. The issue of whether allocation of resource rights constitutes a subsidy is linked to the much more general issue of whether the allocation of water rights or pollution rights constitute a subsidy.

Perhaps the most interesting question is whether provinces are prepared to participate in international commitments to limit bidding wars in attracting new investment. Similarly, will provinces be prepared to accept restraints on subsidies or other measures intended to forestall plant closings?

LONGER-TERM ISSUES

There are longer-term questions of what will be the dynamics of a world of trading blocs. In addition to the consolidation and expansion of the European Community, Mexico is now preparing to negotiate a free trade arrangement parallel to, and possibly linked with, the Canada-U.S. Free Trade Agreement. The new Asia-Pacific Economic Cooperation mechanism is viewed as possibly leading to a Pacific trading bloc. However, the Pacific countries through this new Asia-Pacific Economic Cooperation process have stressed that their first and primary goal is to strengthen the multilateral system and to make sure that the Uruguay Round negotiations come to a constructive conclusion.

There is a potentially important linkage between the GATT agenda and various unilateral processes under U.S. legislation. The U.S.-Japan "Strategic Impediments Initiative (SII)" talks have finessed the Super 301 process pending the completion of the Uruguay Round. A constructive outcome of the Round will help to manage some of the bilateral tensions between the United States and Japan. However, if the Uruguay Round fails, then U.S.-Japan tensions could escalate rapidly.

The Uruguay Round is the most complex and protracted set of multilateral negotiations ever held under GATT auspices. Old problems such as agricultural trade problems and safeguards, present difficult problems for resolution. New issues such as trade in services, investment and intellectual property are also likely to present serious difficulties for the negotiations. There are questions about the coverage of these obligations and their interrelationships, which will emerge if the Uruguay Round does reach significant agreements across the whole agenda. Of course, the conclusion to the Uruguay Round may involve plurilateral arrangements among some or all of the industrial countries and some groups of developing countries, but ones which are open to other countries that are prepared to meet the conditions. This plurilateral approach was followed at the end of the Tokyo Round and the result was a series of separate self-standing codes, such as the Subsidies Code or the Procurement Code, which have their own dispute settlement arrangements.

John Jackson has recently observed:

> The old comfortable procedures of diplomacy among a small group of similar nations will no longer suffice for the GATT. A rule-oriented "constitution" is evolving and is badly needed. A successful completion of the very ambitious Uruguay Round will only reinforce that need. (The proponents of an intellectual property agreement in GATT are among those who have made this quite clear.) In addition, such a successful completion will in fact require some fundamental changes in the GATT "constitution." The critical question is whether those changes will be carefully thought through or be merely the result of the happenstance of the negotiation end-game.[21]

Current Canadian policy is strongly supportive of efforts to strengthen the multilateral system, but Canada will also need to formulate a coherent strategy for bilateral and plurilateral initiatives within this multilateral framework.

Canadian Federalism: Healthy Rivalry or Destructive Fragmentation?

From considerations of the broader international economic context one can come, finally, to a consideration of the impact of Canada's federal system on our ability to respond to the broader context. Federalism as a basis for organizing governments is not widely regarded as a virtuous system by Canadians. Indeed, if you were to ask many Canadian business people or journalists — some of the influential elites in the country — the federal structure of the country would be regarded by many as an unfortunate but necessary consequence of Canada's historical circumstances and regional diversity. Few would trumpet Canada's *de facto* executive federalism arrangements as being a very effective democratic system of governance.[22] However, Albert Breton has argued:

> that parliamentarism and federalism are congruent, that the issue of having to give priority to either in opting for democracy is a false one; and that it is possible to

> reform our national and federal institutions in ways that increase their effectiveness, while remaining true to their fundamental genius...Parliamentary government combined with federalism give the citizens of a country a more effective set of institutions for reflecting their will, preferences and aspirations. Responsible government is democratic government; but responsible government plus federalism is extended democracy, simply because there is more competition.[23]

Breton's concept of competitive federalism is consistent with a concept of Tiebout-style locational competition.[24] Breton refers to this as horizontal competition among provinces. In addition, Breton considers vertical competition between federal and provincial governments. To this list one might add internal competition in the form of competition among agencies and departments within the federal government or within various provincial governments.

The concept of competition within or among governments is not widely applauded. Competition among firms in the market is recognized as leading to price competition which offers benefits to consumers. However, rivalry among government agencies is viewed very differently. Government departments, whether federal or provincial, are expected to be assigned to narrowly defined water-tight compartments and no resources are to be wasted by overlapping activity.

There are two questions which might be raised about policy or administrative measures undertaken by federal or provincial government agencies that might be grouped under the rubric of trade and investment strategies. The first question is, is there waste and inefficiency associated with the duplication of services by federal and provincial efforts to promote trade and investment? The second question is whether various provincial and federal measures which influence merchandise trade, trade in services, investment decisions or labour certification and mobility have economic or societal costs.

TRADE AND INVESTMENT PROMOTION

Over the last decade the larger provinces have substantially increased their effort in promoting trade with, or investment in, their province — see figures 1, 2 and 3 at the end of this chapter — at the same time real federal expenditures have declined since 1983 and are roughly comparable to 1978 levels. One question that might be raised about this increased provincial effort is that it has led to excess capacity in these kinds of services. However, the issue of excess capacity cannot be evaluated solely with respect to the existing level of utilization, but must be judged according to the potential need as adjustment in Canada's external balance proceeds.

Canada is not unique in the degree of activity by subnational governments, as Earl Fry's paper in this volume indicates. A recent study by the Congressional Budget Office concluded:

> State governments over the past few years have increasingly expanded programs to promote exports, seek foreign investment, and attract foreign tourists. The expansion of these programs reflects efforts by States to respond to the growing globalization of the world economy. States view international business programs as an important tool in promoting State economic development. States spent a combined total of $65.5 million on international business activities in 1988, maintained 691 staff personnel, and operated 132 overseas trade offices. For example, all 50 States sponsor seminars or conferences to promote exports or export awareness, assist firms in overseas trade shows, and conduct overseas trade missions to promote exports and/or foreign investment. In addition, 49 States provide one-on-one counselling on exporting; 48 disseminate foreign sales leads to businesses; 43 maintain at least one overseas trade office; 43 have matchmaker programs; 33 provide market studies on potential overseas markets; 33 support a foreign buyers program; 32 issue newsletters on international trade; 23 promote international joint ventures; 21 operate export financing programs; and 20 publish how-to-export handbooks.[25]

Since Canada will face particular challenges in diversifying the regional pattern of its trade and the composition of its trade, there is reason to reject the proposition that there is excess capacity generated by overlapping federal and provincial efforts in this area. One, however, might conclude that federal effort in this area has been lagging, no doubt due to the overall pressures of the budget deficit and the need for fiscal restraint. Collaborative arrangements involving federal and provincial governments and private sector organizations might be desirable in order to obtain maximum impact from the scarce resources available from Canadian governments.

THE ECONOMIC UNION

It is difficult to construe the intentions of the Fathers of Confederation in the 1860s, but it would appear they contemplated relatively benign Tiebout-style locational competition among provincial governments. There are provisions in the *Constitution Act of 1867* that circumscribe the ability of provinces to levy tariffs or equivalent measures on trade in goods among the provinces but there are few other explicit restrictions on the ability of provinces to impose nontariff barriers to trade in goods or services or indeed impose restrictions on the mobility of capital and labour. Of particular note is the fact that the Canadian constitution provides no constraint on the use of subsidies by provincial governments that may have impact on investment in, or trade with, other provinces. In contrast, the European Community, which was formed almost a century later, incorporated explicit rules of competition to control the use of subsidies by member states.

There is considerable variance in the views about the significance and consequences of various federal and provincial measures that tend to inhibit trade in goods and services or factor flows within the Canadian economy. Flatters and Lipsey concluded:

> Our survey of the state of the Canadian common market and the divisive forces now acting on it leaves us to conclude that sustained effort and foresighted policy measures will be necessary to prevent Canada from being pulled down by these forces. If we do not want the judgement of history to be that the realities of politics and economics were stronger than the vision of nationhood for a people that were neither American nor European but a distinctive third force of their own, then acts of foresight and statesmanship are needed. The preservation of Canada requires recognition of the pervasiveness of the present divisive forces of apparent provincial and federal self-interest, and the creation of a strong set of institutions that will keep the forces in check in the longer run self-interest of all Canadians.[26]

Since the economic union was a major part of the terms of reference for the Macdonald Commission, the issue of various barriers to commerce within the Canadian economy attracted considerable attention in the Commission's final report. In its analysis, however, the Commission concluded that interprovincial barriers to trade in goods and services to capital mobility and to mobility of people had modest economic costs.[27]

Some of the ways in which the provinces currently protect and discriminate in favour of local producers and their geographic markets are the following:

- provincial preferential procurement policies;
- some restrictions on labour mobility;
- interprovincial trucking regulations;
- liquor distribution and marketing practices;
- product standards and regulations;
- differential tax treatment; and
- agricultural policies, including marketing boards.

In addition, there are policies which segment capital markets and restrict labour mobility such as certification issues.

One can debate the magnitude of the cost of these interprovincial barriers, but it is remarkable that unlike the European Community, Canada has not responded to increased international competition by promoting internal integration. The estimates of the economic costs of these barriers within Canada may fail to capture some of the dynamic gains from trade. Beyond the economic costs of fragmentation of the Canadian market, these internal barriers gnaw at the sinews of political union because they create perceived inequities of opportunity for citizens. They also undermine political support for equalization when mounting debt-service requirements put pressure on government spending.

WHITHER THE ECONOMIC UNION?

The cynical observation has been made that Canada is an archipelago of regional economies six-thousand miles long and one-hundred miles wide, held together by bribes. A similarly cynical corollary would be that the persistently large federal budget deficits over the last two decades and the resulting accumulation of federal debt in excess of 50 percent of GNP have done more to undermine the future foundations of Canadian unity than have constitutional conflicts.

There are two objections that can be made to this bribe theory of Confederation. The first is noneconomic. Although Canadians may have less enthusiastic attachment to the symbols of nationhood than many countries, and the common bonds of citizenship may be fraying because of heightened regional and linguistic tensions, these factors only serve to illustrate that citizenship transcends simple economic bargains. Perhaps only Canadians, among the industrialized democracies, would construct simplistic Balance Sheets of Confederation.

The second objection is that even if nationhood can be reduced to economic bargaining, the bargaining should not be conceived of narrowly, and it should not be assumed that the bargaining is zero-sum involving the redistribution of a fixed economic pie. Maxwell and Pestieau, and also Whalley and Trela, have discussed the surplus from Confederation recognizing that there are *potential* economic gains from the Canadian common market.[28]

The concept of economic gains from Confederation must be distinguished from a trade diversion or Comecon model of Confederation. Concerns are expressed that the Canada-U.S. Free Trade Agreement will erode east-west ties. This view fails to recognize that Canada retains significant trade barriers such as quotas on dairy and textile products. More importantly, the trade diversion argument is flawed in principle. Some hold a romantic Marxist-Leninist view that workers in Ontario, and farmers in Saskatchewan, and fishermen in Atlantic Canada will achieve greater solidarity if they barter wheat and fish for steel and automobiles. However, such appeals to solidarity based on interregional barter are likely to ring hollow unless there are genuine gains from trade. In Canada, tariffs or other international trade barriers may increase interregional trade volumes at the expense of an overall reduction in Canadian living standards. Far from promoting solidarity, the forced purchase of domestic products at prices above world prices create regional stresses. Interprovincial or interregional barriers have a different dynamic because removal of these barriers simultaneously promotes interregional trade and improves economic welfare.

As was noted previously, individual provinces or the federal government responding to particular interest groups can act in ways that dissipate the potential gains. Flatters and Lipsey characterize the issue of interprovincial restrictions as a prisoners' dilemma game:

> This is...the dilemma of empire building and interprovincial restrictions to trade. If one province plays the restrictive game, it can do better than free trade, but if they all play it, they all do worse. Yet rational calculation of self-interest where there is no co-operation on policy setting leads to behaviour that *minimizes* joint GNP. Only by cooperating and agreeing not to try to exploit the other's passive behaviour can the provinces agree to stay at the joint-maximizing position of mutual free trade. But political pressures to depart from such an agreement are so strong that some kind of "binding oneself in advance" such as is found in the rules of the GATT and the EEC or in the Australian Constitution seems to be necessary if such agreement is to be anything more than an ephemeral affirmation of the motherhood principle.[29]

Leaving aside for the moment the question of what form of arrangements will promote realization of cooperative outcomes, it must be recognized that the prisoners' dilemma situation does not apply in every instance. Consider the example of a smaller province in Atlantic Canada, which has preferential procurement practices which restrict interprovincial trade. That particular province may suffer some economic losses because of the preferential procurement policies of other provinces, but because that particular province's exports are concentrated in primary products or processed resource products and it is a persistent large net importer of products that are procurement-intensive, that particular province may obtain net benefits from procurement preferences as compared with the situation where all provinces abstain from procurement preferences.

What are the incentives for provincial governments to participate in either interprovincial or federal-provincial arrangements to limit interprovincial barriers? The answer is either agenda broadening at the domestic level or linkage with international agreements that bring more issues onto the negotiating table. The choice of one of these routes to resolve interprovincial differences has significant implications.

Consider first broadening the domestic negotiating agenda. Assuming that the potential economic surplus from Confederation is not fully, or more than fully, dissipated, then broadening the agenda from a single issue such as procurement preferences to the full range of interprovincial restrictions on trade in goods and services and factor flows may reduce the asymmetry of interests that arise for some provinces in the specific example of procurement. More broadly, if the trade issues were linked to other issues such as fiscal arrangements, then incentives for cooperation are likely to become more symmetric. For example, if federal fiscal transfers to the provinces were paid conditional on conformity with a code of conduct on interprovincial trade barriers, this would increase incentives for cooperation. Such measures appear

Draconian relative to current norms of federal-provincial relations in Canada, but they serve to illustrate the extent of domestic agenda broadening that may be necessary to achieve greater symmetry in economic interests. (It may also be possible to appeal to noneconomic objectives instead of invoking such blatant pressure tactics but this approach has not been very effective so far.)

The alternative route to resolving the asymmetry of interests involves linking resolution of interprovincial restrictions to the negotiation of international commercial agreements. For example, the hypothetical Atlantic province may be prepared to enter into a federal-provincial arrangement on procurement as part of an arrangement to implement an international agreement on procurement, such as the extension of the procurement code that could emerge from the Uruguay Round of GATT negotiations. The GATT negotiations offer the potential benefit of enhanced access to offshore markets for processed resource exports and, thus, offer greater opportunities for investment and employment in resource processing industries.

Muddling Through: Is It Enough?

Canadians eschew grand strategies and make a virtue of pragmatic "muddling through." Grand visions can lead to disaster, if the assumptions on which they are based are not valid, but a "muddling through strategy" can also lead to costly consequences if fundamental long-term problems are ignored.

CHALLENGES FOR CANADA

The strengthening of economic linkages among the western Pacific and European economies poses particular challenges for Canadian business. Canadian investment in Japan, Korea and the ASEAN economies has been limited, which will make it more difficult to expand trade with this region. Canadian investment links with Europe are also limited, except for Canadian investment in the United Kingdom. Canadian firms will need to develop new trade and investment strategies if they are to forge complementary links with the expanding links among the western Pacific and European economies as well as meet the challenge of Mexico's liberalization. Canadian governments will need to promote actively the diversification of Canada's trade and investment links with these dynamic economies in order to build on the opportunities flowing from the Canada-U.S. Free Trade Agreement. This necessity is reinforced by Canada's large current account deficit and the eventual pressures to unwind global trade imbalances.

The ambiguity of the international trade rules for subsidies and countervailing duties creates difficulties for Canadian provincial and federal governments.

Innovation by, and competition among, provincial governments in offering a wide range of amenities and in fostering a skilled labour force with the least tax burden is an essential element in responding to global competition. Yet the existing international trade rules do not provide much guidance to policy-makers in determining when provincial measures are healthy competition and when they may result in destructive rivalry and lead to debilitating trade frictions.

The economic challenges for Canadian governments collectively are whether they can develop domestic economic policies that take account of global economic developments. Are they prepared collectively to participate effectively in the emerging international negotiations agenda on agricultural subsidies and import barriers; public procurement practices; rules for industrial subsidies and standards (including environmental issues); services; and investment issues (including restrictive business practices); and to implement international agreements in these areas? Have we thought these issues through or are we prepared to leave it "to the happenstance of the negotiation end-game"? The ability of Canada's executive federalism to deliver on provincial commitments have been tested very cautiously in the Canada-U.S. FTA. If progress is achieved across the full Uruguay Round agenda, then the capability of Canada to enter into international obligations with respect to provinicial policies and practices could be tested much more stringently.

Although the Uruguay Round negotiations, or various GATT disputes, could be a useful catalyst to the removal of internal barriers within Canada, it is to be regretted that Canadian governments have such difficulty in removing internal barriers in order to serve domestic objectives. At a time when the ties of Confederation are strained, political efforts to expand the economic gains from the Canadian economic union could yield significant economic and political benefits.

NOTES

1. Brian Hindley, "Antidumping as a Threat to the GATT," in Murray Smith (ed.), *Canada, the Pacific and Global Trade* (Halifax: Institute for Research on Public Policy, 1989).
2. These numbers are not forecasts, but illustrate how macroeconomic adjustment stemming from significant movements in exchange rates and differential income growth can lead to large changes in trade flows. The macroeconomic policy changes that would reinforce these adjustments are discussed below.
3. Japan Investment Study Mission, 22 October-2 November 1989, *Japan and Canada: Partnership for Prosperity* (Ottawa: Minister of Supply and Services, 1990).

4. This literature has been extensively surveyed. See, for example, Richard G. Harris "The new protectionism revisited," *Canadian Journal of Economics XXII* no. 4 November 1989, pp. 751-78; J.A. Brander, " Shaping Comparative Advantage: Trade Policy, Industrial Policy, and Economic Performance" in Richard G. Lipsey and Wendy Dobson (eds.), *Shaping Comparative Advantage* (Toronto: C.D. Howe Institute, 1987); and A.K. Dixit, "Trade Policy: An Agenda for Research" in Paul Krugman (ed.), *Strategic Trade Policy and the New International Economics*, (Cambridge, MA: MIT Press, 1986), pp. 283-303.
5. J. Eaton and G. Grossman, "Optimal trade and industrial policy under oligopoly," *Quarterly Journal of Economics*, 101, pp. 383-406.
6. See, for example, Jagdish N. Bhagwati and T.N. Srinivason, "Directly Unproductive Profit-Seeking (DUP) Activities," in J.N. Bhagwati and T.N. Srinivason, *Lectures on International Trade* (Cambridge, MA: MIT Press, 1983) pp. 313-334.
7. See Richard Lipsey, "Models Matter," in *Shaping Comparative Advantage*.
8. Ronald J. Wonnacott and Paul Wonnacott, *Free Trade Between the United States and Canada: The Potential Economic Effects* (Cambridge, MA: Harvard University Press, 1967).
9. Richard G. Harris with David Cox, *Trade, Industrial Policy, and Canadian Manufacturing* (Toronto: Ontario Economic Council, 1983); and Paolo Cecchini, *The European Challenge 1992: The Benefits of a Single Market* (Aldershot: Wildwood House, 1988).
10. Technically this would result in a downward shift in the firm's cost curve as compared with a movement along the cost curve if scale economies are realized.
11. Michael Porter, *The Competitive Advantage of Nations* (New York: Macmillan, 1990).
12. Donald J.S. Brean, *International Issues In Taxation: The Canadian Perspective* (Toronto: Canadian Tax Foundation, 1984).
13. See Richard G. Lipsey and Murray G. Smith, "An Overview of Harmonization Issues," in Lipsey and Smith (eds.), *Policy Harmonization: The Effects of the Canadian American Free Trade Area* (Toronto: C.D. Howe Institute, 1986).
14. See, for example, Charles Tiebout, "A Pure Theory of Local Expenditure," *Journal of Political Economy*, vol.64, 1956, 416-24.
15. See Ronald J. Wonnacott, *Canadian and U.S. Adjustment Policies in a Bilateral Trade Agreement* (Toronto and Washington, D.C.: Canadian American Committee, 1987.) The Macdonald Commission proposed sweeping overhaul of the unemployment insurance and tax system but these recommendations have received much less attention and there is more political resistance to these policy changes.
16. See Robert York (ed.), *Taking Aim: The Debate on Zero Inflation* (Toronto: C.D. Howe Institute, 1990).
17. See Murray G. Smith (ed.), *Global Rivalry and Intellectual Property: Developing Canadian Strategies* (Institute for Research on Public Policy, 1991).
18. For an overview of the Uruguay Round from a Canadian perspective, see Murray G. Smith, "Editor's Introduction: Canada and the Pacific in The Uruguay Round and the Multilateral Trading System" in *Canada, the Pacific and Global Trade*.
19. Indeed tariffs still matter in trade with the United States, because the tariff reductions are being phased in, and because of the rules of origin in the Canada-U.S. FTA.

20. Brian Hindley, "Anti-dumping Action: How the GATT is Threatened," in Murray G. Smith (ed.), *Canada, the Pacific and the Uruguay Round* (Halifax: Institute for Research on Public Policy, 1989).
21. John H. Jackson, *Restructuring the GATT System* (London: The Royal Institute of International Affairs, 1990).
22. One of the objections made by some to the Meech Lake Accord is that it would have formalized executive federalism by requiring annual First Ministers' meetings.
23. Albert Breton, Supplementary Statement, *Report of the Royal Commission on the Economic Union and Development Prospects for Canada.* (Ottawa: Minister of Supply and Services, 1985), pp. 487-88.
24. See also, Albert Breton and Anthony Scott, *The Economic Constitution of Federal States* (Toronto: University of Toronto Press, 1978).
25. W. Morrison, *State International Trade Programs* (Washington D.C.: Congressional Budget Office, 1990).
26. Frank R. Flatters and Richard G. Lipsey, *Common Ground for the Canadian Common Market* (Montreal: The Institute for Research on Public Policy, 1983), p. 45.
27. *Report of the Royal Commission on the Economic Union and Development Prospects for Canada*, vol. III, pp. 120-34. This analysis was based on research by John Whalley and others published in Michael Trebilcock et.a. (eds.), *Federalism and the Canadian Economic Union* (Toronto: University of Toronto Press for Ontario Economic Council, 1983); and John Whalley and Irene Trela, *Regional Aspects of Confederation*, Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada, vol. 68 (Toronto: University of Toronto Press, 1986).
28. Judith Maxwell and Caroline Pestieau, *Economic Realities of Contemporary Confederation* (Montreal: C.D. Howe Research Institute, 1980) and John Whalley and Irene Trela, *Regional Aspects of Confederation*, (Toronto: University of Toronto Press for the Royal Commission on the Economic Union and Development Prospects for Canada, 1986).
29. F. Flatters and R. Lipsey, *Common Ground*, p. 49.

Figure 1

Provincial and Federal Expenditures on Trade and Investment Promotion in Nominal Dollars

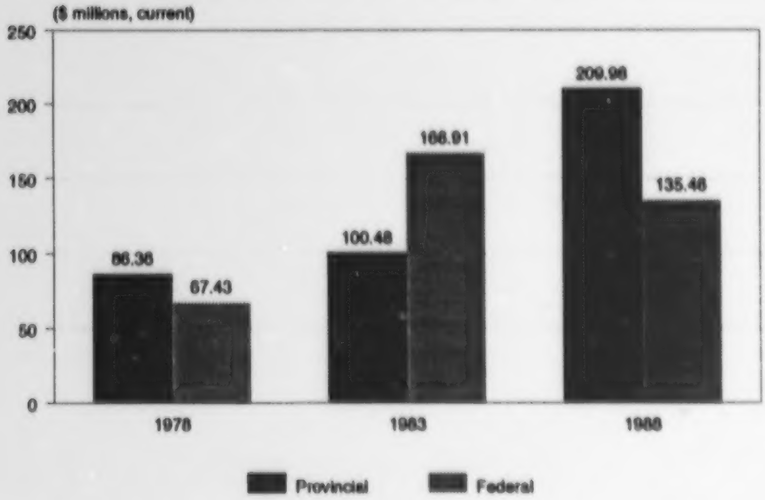


Figure 2

Relative Share of Total Federal and Provincial Trade and Investment Promotion Expenditures

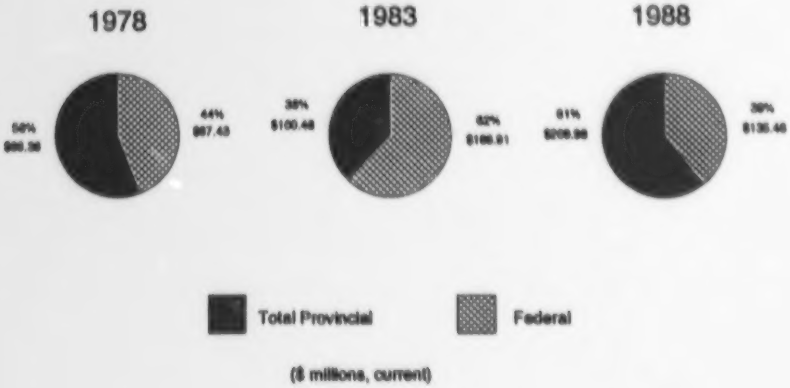
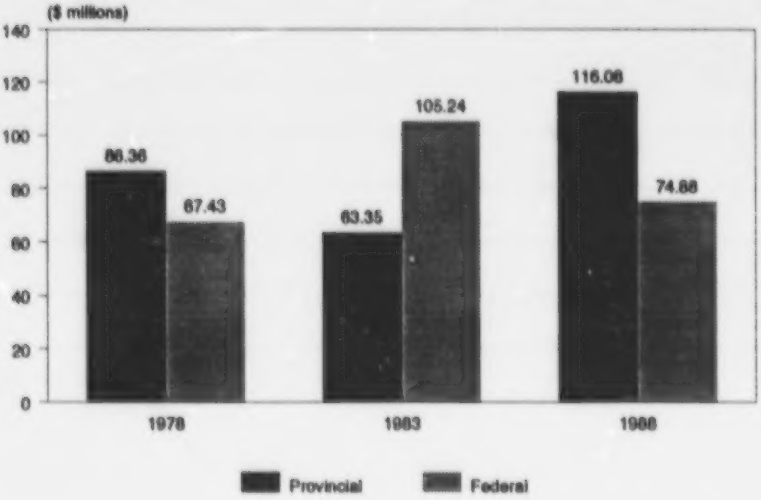


Figure 3

Federal and Provincial Expenditures on Trade and Investment Promotion, in Real (1978) Dollars



Trade and Investment Promotion in the United States: New Frontiers[1]

Earl Fry

An Era of Interdependence

With a population base of one-quarter billion, the United States enjoys an annual gross national product of $5.2 trillion, about 23 percent of the global total and almost two-thirds larger than the annual production rate of the world's second major economy, Japan. The United States is also the world's largest trading nation and surpassed West Germany in 1989 as the number one exporter. In addition, the U.S. ranks globally as the leading foreign investor and host nation for foreign investment.

Yet in spite of these impressive statistics, the 1980s was an extremely difficult decade for the United States as it grappled with the vicissitudes of a complex and interdependent global economy. For example, U.S. exports reached record levels in both 1988 and 1989, but when freight and insurance charges are added in, the cumulative U.S. deficit in merchandise trade during the past ten years was close to $1 trillion. The United States also began the 1980s as the world's largest creditor nation, and exited the decade as the largest debtor, with over $600 billion in net overseas obligations. Furthermore, foreign direct investment, which provides an overseas investor with a controlling interest in an American enterprise, more than quadrupled during the past decade and has resulted in almost 4 million Americans now working for foreign-owned companies in the United States.

At the grassroots level, U.S. state and local officials are keenly aware of the impact that both national and global competition is having on the people they represent. In the spirit of "thinking globally and acting locally," 41 of the states have now opened almost 120 offices in 24 countries to promote trade, investment, and tourism, about twice the level of 1986.[2] To put this subnational governmental activity in perspective, the federal government currently operates 127 special foreign commercial posts in 65 countries. In addition, more states now maintain offices in Japan (39) than in Washington, D.C. (33).[3] Moreover, in the past five years California's Export Finance Office alone has issued almost as many loan guarantees as the Export-Import Bank of the United States has made nationwide.[4] Major cities also sponsor annual international trade and investment missions, and about 1,000 of America's 36,000 municipal and township governments are actively involved in international programs.[5] All of this subnational activity has occurred during a period when the U.S. Foreign and Commercial Service, the federal agency assigned to help American companies to export, has seen its budget cut by 20 percent in real terms in the past five years and its staffing reduced by 10 percent.[6]

Over the past decade, state and local governments in the United States have been actively engaged in developing subnational level industrial policies, with the goal of protecting and enhancing the economic interests of the constituencies who live within their fixed jurisdictions.[7] Without any doubt, a major motivation for this new emphasis is the shrinking transfer payments from Washington, D.C. In constant dollars, federal aid to the states and cities peaked in 1978, and fell by almost 40 percent in real terms from 1980 through 1988.[8] The Gramm-Rudman deficit-reduction measures are expected to exacerbate even further the transfer problems in the 1990s, and the federal government already spends much more on interest payments on the national debt than on state and local government programs. Furthermore, much of the current assistance is linked to mandated health and social welfare programs, which are only tangentially linked to economic development activities.[9]

In an effort to achieve some semblance of self-sufficiency and economic diversity at the subnational level, economic development agencies at the state level are devoting over one-half of their time to in-state business development, almost one-third to attracting firms elsewhere in the United States, and about 15 percent to attracting foreign companies.[10] At the county and municipal levels, an additional 11,000 economic development groups have been formed across the United States, excluding the 9,000 or so local chambers of commerce.[11] Some observers now refer to the state governments as the "dynamos" of the U.S. federal system, and there is no doubt that their policies will have a growing impact during the 1990s upon U.S. commercial relations at home and abroad.[12]

The intent of this paper is to acquaint the reader with the trade and investment promotion policies of U.S. state and local governments and to examine briefly the potential implications of such policies for the Canada-U.S. Free Trade Agreement and the ongoing Uruguay Round negotiations.

State and Local Governments as Formidable Economic Actors

The ability of U.S. state and local governments to influence domestic and international commerce positively or negatively should not be underestimated. Among the 25 leading nations in the world ranked by gross national product, one could insert 12 states. Moreover, America's smallest state, Vermont, would rank 67th among the approximately 170 nation-states in the world. California, with its 29 million people, now accounts for more than $600 billion in annual gross state product, and would rank as the seventh largest country globally. New York is not far behind with its top 10 ranking, and Texas alone produces more than neighbouring Mexico. These states are also important trading clients for many countries, with California ranking as Japan's second leading partner after the rest of the United States.

Furthermore, the annual budgets of states such as California and New York, which are now approaching $50 billion, are surpassed by only a handful of national governments around the world. To put this purchasing power in perspective, California's budget is four times greater than the Philippines, a nation with 56 million people. At the municipal level, New York City's annual budget is also twice as large as that of the Philippines, and the four-county Los Angeles metropolitan area, with an annual production of goods and services exceeding 250 billion dollars, ranks as the eleventh largest economic power in the world ahead of Australia, Switzerland, and India. In 1986, total state and local government personal income, sales, and property tax receipts were greater than the federal government's personal income tax revenues, and state and local government purchases of goods and services amounted to 85 percent of non-defence purchases by all levels of government in the United States.[13] In 1988 alone, state and local governments in the United States accounted for $648 billion in expenditures, of which $584 billion was earmarked for the purchase of goods and services.[14]

Financial Incentives for the Promotion of Investment

The National Association of State Development Agencies (NASDA), in its periodic survey of the states, suggests that one of the major trends of the 1980s was "the enormous increase in business financing programs."[15] In 1988, 48 state governments offered tax exemptions on goods in transit, 45 tax exemptions for raw materials used in manufacturing, 44 tax exemptions for manufacturers' inventories and new equipment, 38 loans for building construction and the purchase of equipment and machinery, 35 tax incentives for job creation, 34 corporate income tax credits for enterprise zones, 32 tax incentives for industrial investment, 31 financial incentives for establishing industrial plants in areas with high unemployment, 28 funding-for-venture capital programs, 28 personal income tax exemptions, 25 tax incentives for research and development projects, 19 excise tax exemptions, and 18 tax credits for new investment.[16] These programs are in addition to federal assistance provided through the Small Business Administration (SBA) loan and loan guarantee programs, the Urban Development Block Grants (UDAGs), the Community Development Block Grants (CDBG), the Business and Industrial Loan programs, the Economic Development Agency (EDA) programs, the HUD Section 108 program, the Job Training Partnership Act (JTPA) program, and a wide variety of defence and other related programs.[17] That same year, 44 states authorized state revenue bond financing and 49 permitted municipal or county revenue bond financing. Long-term tax-exempt bonds have been an extremely important economic development tool for state and local governments over the past few decades, with $687 billion in all types of long-term state and local tax-exempt bonds issued in the five-year period ending in 1988 in the 50 states, the District of Columbia, and the U.S. territories in Guam, Puerto Rico, and the Virgin Islands. Recently, the issuance of tax-exempt bonds has been severely hindered as a result of the 1986 *Tax Reform Act*, and potentially by a Supreme Court decision rendered in April 1988 which gives Congress a green light to tax interest on state and local government-issued bonds. Nonetheless, the authority to issue small-issue industrial development bonds has been extended by the federal government through 1990 and will likely be prolonged even further into the 1990s. Consequently, state and local governments may continue to issue up to $10 million in tax-exempt bonds to finance specific manufacturing projects. Some states, such as California, have even authorized the use of general obligation bonds to help local governments finance business development.[18] Subnational governments may also issue an unlimited amount of "taxable" bonds, which are frequently exempted from state and local taxation.

TARGETED INVESTMENT ATTRACTION AND RETENTION

Many states and communities have been engaged in a rather controversial policy of offering lucrative incentive packages in order to attract or retain individual businesses. Frequently, the incentive packages run into the tens of millions of dollars per deal and include: (a) tax forgiveness for up to 20 years; (b) low-interest loans; (c) grants; (d) donations of land; and (e) job-training subsidies.[19] For example, the Minnesota legislature passed a $1.2 billion three-year incentive package in an unsuccessful bid to lure General Motors' Saturn auto assembly plant, including $800 million in tax breaks, $93 million in direct costs, and $371 million in incentives from the private sector.[20] In 1989, Sears received from the state of Illinois and the town of Hoffman Estates an incentive package worth $178 million, and the right to develop 600 acres of free land commercially over a 20-year period, in return for basing its merchandise group in this prosperous community 35 miles northwest of Chicago. This group had previously been based in Chicago since 1887.[21] In 1985, the state of Illinois, McLean County, and the cities of Normal and Bloomington pieced together an incentive package worth $168 million to attract the Chrysler/Mitsubishi Diamond Star auto plant. The package included the creation of a special enterprise zone authorized to operate through 1998 and such benefits as (a) infrastructure improvements specifically geared to Diamond Star's requirements, (b) services such as worker training and Japanese-style education for the children of Japanese managers, (c) tax abatements, and (d) priority access to industrial revenue bonds.[22]

In order to retain businesses and the accompanying jobs in New York City, municipal and state officials have since 1983 provided Chase Manhattan with incentives worth $235 million, NBC $98 million, Shearson Lehman Hutton $74 million, Drexel Burnham Lambert $85 million, Citicorp $97 million, and Dreyfus Corp. an annual incentive of $4 million. In addition, AT&T was provided with $42 million in tax breaks by the city to build its headquarters in Manhattan, and the luxurious Trump Tower on 5th Avenue, with its million-dollar condos and six levels of retail space, was subsidized with $100 million in tax abatements. Indeed, New York City officials have deliberately assessed commercial property at no more than 60 percent of fair market value. For example, the Pan Am Building was sold for $400 million in 1980, but its assessed value was only 25 percent of the selling price. Manufacturers Hanover Trust Building was sold for $161 million in 1981, but carried an assessed value of 20 percent of the actual purchase price.[23] It is estimated that New York City's incentive programs have cost at least $2 billion in public revenues over the past decade.[24]

Other leading business attraction incentive packages include the $60 million pledged to Sematech to locate in Austin, Texas, and the $50 million to

Burlington Air Express to build a hub in Toledo. Detroit has also handed out about 100 million dollars in tax abatements over the past few years, mostly to the automakers, and Indianapolis provided $155 million in tax abatements from 1984 through 1987.[25] Pennsylvania won the ill-fated battle among the states to attract a Volkswagen assembly plant, offering an incentive package valued in excess of $70 million. VW closed its Pennsylvania plant in 1988, but will continue to collect incentives through most of the remainder of the century. In later bidding contests, Ohio agreed to provide Honda with $70 million in incentives, Tennessee offered Nissan $66 million, Michigan offered Mazda $120 million, and Kentucky will provide Toyota with an estimated $325 million over a 20-year period.[26]

ENTERPRISE ZONES AND RELATED PROGRAMS

The enterprise zone program began in Connecticut in 1982 and now has spread to 36 other states and the District of Columbia. More than 1,500 zones have been approved, with Louisiana by itself designating up to 750 enterprise zones. Moreover, nearly the entire cities of Toledo and Cleveland are now huge enterprise zones.

In terms of financial incentives the Evansville, Indiana enterprise zone may serve as a typical example of the zones currently in operation in the United States. Firms willing to locate in the zone are eligible for state tax credits for interest on loans, employee wages (up to $1,500 per employee), and property taxes, plus city tax exemptions for inventory and for finished goods sold outside Indiana.[27]

California designated its nineteenth zone in 1989, with most operating only over the past couple of years. Approximately $3 million in state incentives are currently available to a plant employing 100 workers, with the two major tax benefits being a credit of up to $19,000 for hiring economically disadvantaged employees and a sales tax credit of up to $1.2 million per company on certain equipment and machinery purchases. Businesses would also be entitled to a 100 percent net-loss carryover from year to year, accelerated depreciation allowances, tax-free interest on special loans, and preferential treatment in the allocation of certain industrial development bonds.[28]

Almost all the states limit the designation of enterprise zones to depressed areas with endemically high unemployment. However, as has been the case with tax incentive financing (TIF), these rules have been ignored at times for the sake of expediency. As an illustration, enterprise zones were created for Sears and Chrysler/Mitsubishi in Illinois in communities that were prosperous and already offered a high quality of life.[29] When Chrysler threatened to shut down another Illinois plant in 1985, Governor James Thompson declared the entire plant an enterprise zone, entitling the automaker to industrial revenue bonds, tax abatements, and job-training funds worth $15 million.

TIF is a special financing program that helps cities to circumvent federal restrictions on the issuance of tax-free bonds to assist the business community. A city sets up a redevelopment district around a proposed project, estimates the tax revenues, which will be generated over a 20- to 25-year period, and then issues tax-exempt bonds. Future revenues from the completed project will then be used to service the bond debt. California first used TIF in the 1950s for clearing away slum areas, but since the 1986 federal tax reforms, cities and states across the nation have been using TIF for a wide variety of economic development projects. For example, Detroit used it initially to develop property to be used for the General Motors' Poletown plant. The initial financing was supposed to have been 100 million dollars, but the price tag eventually escalated to over $300 million, and Detroit is currently paying $10 million a year in interest with a $50 million balloon payment due in 1996. Furthermore, once the property was developed, it was donated to General Motors.[30] The prosperous community of Hoffmann Estates, Illinois is using TIF to assist Sears, and officials in Marion, Illinois declared the whole city a blighted area in order to issue TIF bonds for a suburban shopping centre. Community leaders in Indianapolis are also using $200 million in TIF funds to develop a downtown mall.

Total government financial assistance in the form of enterprise zones and TIFs is difficult to compute. The Reagan and Bush administrations' proposals to create from 70 to 100 federal enterprise zones have been estimated to cost from $400 million to $1.6 billion per year.[31] If ever enacted, this package would likely include wage and investment tax credits and a capital gains tax exemption. Currently, there are over 500 "active" state-sponsored enterprise zones in operation, with most offering a combination of the following: (a) local property tax abatements; (b) tax credits for hiring new employees; (c) sales tax breaks; (d) tax deductions for capital improvements; (e) low-interest loans; (f) outright grants for businesses; (g) job training funds; (h) new public spending for infrastructure; and (i) government-sponsored marketing for the zone.[32] A HUD report released in 1987 estimates that the enterprise zones have saved or created 180,000 jobs and attracted $8.8 billion in private capital, whereas a more recent *Business Facilities* survey estimates 184,000 jobs were created, 169,000 jobs retained, and $18.1 billion in private investment attracted through 1988.[33] Other studies, however, have concluded that enterprise zones have had only a marginal influence on private investment decisions.[34]

One must also emphasize that targeted economic development policies are not limited to urban areas. Many parts of rural America have suffered significant economic setbacks and population loss during the past decade.[35] In an effort to help their mostly rural-based coal industry and workers, Ohio voters approved in 1985 the issuance of $100 million in bonds to support research on the clean use of Ohio's high-sulfur coal and to establish the Ohio Coal Development Office. The Pennsylvania *Rural Economic Development Act* of 1987 provides assistance for research and demonstration projects related to the disposal and reuse of brine and other wastewaters produced in conjunction with oil and gas operations. Other legislation passed in 1987 directs Pennsylvania's Department of Commerce to assist in the creation of a non-profit agency to promote the state's hardwood industry. That same year, Montana established an Agricultural Development Council that helps to create business incubators and to make seed capital grants in agrarian areas of the state.[36] Many other states have also established programs that offer direct financial assistance for economic development in their rural areas. The federal government, of course, also sponsors its share of rural-oriented programs, with the Rural Electrification Administration (REA) alone having provided an estimated $50 billion in economic subsidies to borrowers from 1973 through 1988.[37]

Export Assistance

All 50 states and many major municipalities now provide significant export assistance to small- and medium-sized firms. The states spent $62 million in staffing and maintaining their trade departments in 1988, almost double the 1984 expenditures.

EXPORT FINANCING

At the end of 1988, 27 states had passed legislation to implement some form of export financing. Twenty-two of these programs were operational with over $32 million allocated for financing purposes, most commonly for loan guarantees to commercial banks willing to issue loans to small- and medium-sized exporters. The California Export Finance Office (CEFO) is a leader in providing financial support to small- and medium-sized businesses. Since its inception in 1985 through the end of October 1989, CEFO guaranteed 181 working-capital loans representing $34.6 million and export sales of $154 million.

The U.S. Export-Import Bank is also working with 12 state and city governments to provide joint financing and other types of assistance to small- and medium-sized firms, helping to support $40 million in exports through the end of 1989.

OTHER TYPES OF EXPORT ASSISTANCE

All 50 states conduct trade seminars and provide a host of other assistance programs to companies interested in exporting goods or services.[38] Approximately 220 California companies participated in the California World Trade Commission trade show exhibits from 1985 through the spring of 1989, facilitating $66 million in export sales. These exhibits were focused on such areas as aerospace, telecommunications, computers, medical and scientific instruments, sports and leisure, and energy and environmental technologies.[39] The National Governors' Association has also established a special ExpoLink database service to be used by the states to ascertain three-digit level standard industry classification (SIC) export leads.[40] At the local level, the U.S. Conference of Mayors has conducted trade exhibitions abroad since 1980, permitting city officials to promote their goods.[41] All of these programs help to reduce the costs for companies to gather export data and to market their products abroad.

Subnational Governments and International Trade Accords: The Issue of Subsidies

Under Chapter 19 of the Canada-U.S. Free Trade Agreement, the two North American neighbours have from five to seven years to define what constitutes a subsidy and then to determine how such subsidies will be treated under the bilateral accord. Both sides are also in general agreement that the policies of subnational governments such as state, provincial, and municipal governments must be included in the overall subsidy discussions.

Without any doubt, U.S. subnational governments, which in their own right are powerful economic actors, have entered new frontiers and are now more actively involved in the economic sector than at any other time in the twentieth century, assuming the roles "of market developer, broker, financial partner, and risk-bearer."[42]

With this activist role in mind, what amount of money over the past decade has been transferred from subnational governments to their business communities in the form of targeted financial and other types of direct assistance? This is extremely difficult to calculate and only rough estimates can be made. A National Governors' Association report suggests that the states spent $20 billion on financial assistance to businesses in the year 1981, including incentives designed to attract new businesses or retain existing ones, but excluding public investment in human resources, universities, research institutions and physical infrastructure.[43] Nor does this calculation include county and city spending. If this figure is roughly accurate and if 1981 were fairly typical of the entire decade, then state governments alone may have provided approximately $200 billion in financial assistance to their business communities during the 1980s.

The Public Securities Association (PSA) calculates that $687 billion in all types of long-term tax-exempt bonds were issued by state and local governments between 1984 and 1988. If these bonds had been taxable, the PSA estimates the additional interest costs until the year 2000 would have been $284 billion.[44] Using a similar formula for calculating interest savings for businesses, $220 billion worth of tax-exempt industrial development bonds were issued by subnational governments between 1979 and 1989, leading to savings in interest charges of $103 billion. If private-exempt entity bonds, which assist private hospitals, educational facilities, and similar organizations are included, an additional $63 billion in savings would be added to the equation.[45] These figures do not include "taxable" state and local issuances, which are usually exempted from both state and local taxes.[46]

Using calculations for the proposed federal enterprise zone program and for the existing enterprise zone program in Indiana, one can estimate that the current 500 zones in operation probably provide annually over $1 billion in financial assistance to the business community.

Such direct and indirect assistance from state and local governments to businesses will make it imperative for U.S. negotiators dealing with Canada and with GATT to define very carefully what is meant by a harmful and a benign subsidy.

Quite frankly, if the United States is to become more competitive internationally, it is essential that people, governments, and businesses at the grassroots level think "globally" and implement strategies that will facilitate growing U.S. competitiveness. Consequently, in an effort to enhance the interests of their business communities, subnational governments in the United States have implemented many policies that are desperately needed. At the end of the 1980s, 70 percent of the goods produced in the United States were subject to direct competition from foreign products in America's own marketplace, versus only 20 percent in the 1960s. Traditionally, many small- and medium-sized U.S. businesses have been satisfied to service local and regional markets and have not given a thought to producing goods or services that would be globally competitive. Indeed, in the mid-1980s the President's Commission on Industrial Competitiveness estimated that 250 large firms accounted for 80 percent or more of all American exports.[47] In a rapidly globalizing economy, small- and medium-sized businesses that remain complacent about international competition risk becoming the dinosaurs of the 1990s, losing market share both to large U.S and foreign enterprises.

In an effort to prevent this extinction, U.S. state and local governments are instituting a wide variety of policies to assist these businesses to remain competitive at home and abroad. The impetus for greater export activity that will help to erase America's huge trade deficits must largely be provided at the local level. Both state and municipal governments are providing workshops for small- and medium-sized firms that desire to export. They are also furnishing technical assistance and helping these firms to obtain private financing for export activity. The development of business incubators, greenhouse projects, technology ventures, and related endeavors should also result in greater U.S. exports. Above all, both U.S. state and local governments must have an international orientation and emphasize the development of a favourable business climate stressing education, technology, a skilled work force, a modern infrastructure, a competitive financial network, and a high quality of life.[48]

Arguably, some of these subnational policies may be short-sighted and wasteful. Far too often, subnational governments fail to cooperate in promoting economic development projects that can bring benefits that transcend state and local boundaries.[49] Likewise, financial incentives given to certain companies may provide them with an unfair advantage over competitors who do not receive such incentives. Moreover, 49 of the 50 states require balanced budgets, meaning that targeted incentives may take money away from education, welfare, health care, and infrastructure improvements.[50] Most studies also indicate that investment incentives tend to be given a low priority in corporate decisions concerning site locations.[51]

On the other hand, the future of some U.S. incentive packages may well be linked to what transpires in Canada. Once the Free Trade Agreement is fully implemented at the end of the 1990s, firms situated in Canada will have open access to most sectors in the huge American marketplace. Canadian cities and provinces are now actively recruiting foreign companies, insisting that Canada can offer a better quality of life and still serve as the "gateway" to the huge U.S. market. If Ottawa and the provincial and municipal governments continue to ante up significant financial packages to recruit these businesses, there is no practical reason for American subnational governments to forsake their own incentive programs.

Growing exposure to the international economy has also prompted far too many state and local governments to adopt protectionist policies designed to help marginally competitive local industries to survive. Forty-six states maintain some form of *Buy American* or *Buy State* provisions for state and local government procurement, an increase of one-third since the late 1970s. These provisions restrict or eliminate foreign firms from bidding on more than $20 billion in government contracts annually. Thirty-six state legislatures have also enacted anti-takeover statutes, many patterned after Indiana's law that was upheld by the U.S. Supreme Court in 1987. Over the past few years, state-level protectionist policies have often been used as the last line of defence for U.S.-owned companies resisting unfriendly takeover bids by overseas corporations.[52]

Generally, U.S. trade officials have paid little attention to the dynamic policies now being pursued by state and local governments. In their subsidy negotiations with Canadian representatives and with their GATT counterparts in Geneva, these officials must now take time to look in their own backyard and determine which subnational policies are acceptable and which may violate both the spirit and the letter of Washington's own definition of a harmful subsidy. Currently, the U.S. International Trade Commission and the Department of Commerce distinguish between "generally available" government programs and those available only to specific enterprises; or in other words, "to one company or industry, a limited group of companies or industries, or companies or industries located within a limited region or regions within a country." For the moment, the latter would constitute a harmful subsidy.[53]

In his insightful work on subsidies, Gary Hufbauer suggests the development of a "green list" of acceptable domestic subsidies, a list that would include the following: (a) generally available subsidies involving health benefits, worker training, utilities, roads, and broad tax incentives; (b) adjustment subsidies that are paid strictly for the purpose of downsizing the industry (such as retraining allowances and pension benefits); (c) regional subsidies that solely compensate for demonstrated cost differentials of establishing facilities in the depressed region; and (d) research subsidies, so long as the research findings are released freely into the general body of scientific knowledge or can be licensed by firms of foreign nationality on the same basis as domestic firms.[54]

Yet even under such a liberalized regime, many questions would remain concerning the acceptability of targeted business attraction, business retention, venture capital, technology development, enterprise zone, TIF, export financing, and many other related programs. Because targeted subnational government programs in the United States involve the transfer of billions of dollars per year from the public treasury to the private sector, and many of these programs are assisting America to compete more effectively at home and abroad, officials in Washington, D.C. may have reached the point where they must formulate a policy on subsidies that is even more flexible than Hufbauer's proposal.

In conclusion, the vast majority of trade and investment policies sponsored by U.S. state and local governments are innovative and contribute to U.S. global competitiveness. Nevertheless, some fine tuning of existing targeted programs may be needed, and under the current U.S. definition of what constitutes a harmful subsidy, some of these programs may have to be modified or even eliminated altogether. Both to avoid a politically costly confrontation with state and local governments over subnational trade and investment policies, and to enhance U.S. global competitiveness in the 1990s, the Bush administration would be wise to expand its list of acceptable domestic subsidies.

NOTES

1. Much of this paper was adapted from a manuscript submitted to the Institute for Research on Public Policy entitled "The Economic Development Policies of U.S. State and Local Governments: Implications for the Canada-U.S. Free Trade Agreement."
2. National Association of State Development Agencies (NASDA), "Memorandum on State Foreign Offices," 29 March 1989, and idem, *Directory of Incentives for Business Investment and Development in the United States*, 2d edition (Washington, D.C.: Urban Institute Press, 1986), p. 5.
3. *Governors' Weekly Bulletin*, 14 April 1989, p. 1, and National Governors' Association, "State Offices in Washington," 12 December 1989.
4. Elliot King, "Bridging the Finance Gap for Mid-Sized Exporters," *Global Trade*, July 1989, p. 18. This statement was made by L. Fargo Wells, executive director of the California Export Finance Office.
5. The international involvement of municipalities in the United States and Canada is detailed in Earl H. Fry, Lee H. Radebaugh, and Panayotis Soldatos, (eds.), *The New International Cities Era: The Global Activities of North American Municipal Governments* (Provo: David M. Kennedy Center for International Studies, Brigham Young University, 1989).
6. *San Francisco Chronicle*, 6 November 1989, p. C3. The export promotion staff of the U.S. & Foreign Commercial Service, which is part of the U.S. Department of Commerce, was cut from 142 in 1985 to 115 in 1989, with trade specialists in U.S. field offices cut from 365 to 291, and trade staff in overseas offices, including foreign nationals, cut from 690 to 679.
7. The notion of subnational "fixed jurisdictions" deserves further explanation. Obviously, U.S. state and local governments have limited territorial boundaries, whereas businesses can be much more mobile. For example, in 1987 the sales of affiliates of U.S.-based multinational corporations (MNCs) surpassed $1 trillion, whereas U.S. exports were in the range of $250 billion. The affiliates of U.S.-based MNCs also produce about $500 million worth of products in the European Community each year, while U.S. exports to all of Europe amount to only $70 billion annually. With this in mind, Gary Hufbauer has been prompted to conclude that EC '92 may be a "bonanza for U.S. multinationals, but a question mark for U.S. exporters." (Hufbauer quoted in Bruce Stokes, "Multiple Allegiances," *National Journal*, 11 November 1989, p. 2757). For state and local governments, the "bonanza" is clearly in the form of exports from their areas of jurisdiction, whereas the U.S.-based MNCs may have a far different agenda for maximizing profits.
8. As a fraction of total federal spending, aid to state and local governments fell from 1/6th in 1979 to 1/9th in 1990.
9. Federal funding to the state and local governments amounted to $115 billion in 1988, $121 billion in fiscal year 1989 and is expected to be $128 billion in fiscal year 1990. However, economic development assistance has been stagnant, whereas Congress and the White House have agreed to pass along additional funds to help defray newly-mandated state and local government responsibilities in the areas of Medicaid and other social welfare programs.

10. These figures are based on a 1988 NASDA survey and are found in *The NASDA Newsletter*, 15 November 1988.
11. Donald Haider, "Marketing Places," *Economic Development Commentary*, Spring 1989, p. 15. In his address to the 1989 Congress of Cities, National League of Cities' President Terry Goddard emphasized the theme of "self-sufficiency," stressing that municipal governments could no longer count on assistance from Washington, D.C. (*Nation's Cities Weekly*, 4 December 1989, p. 1). Some state government leaders have used even more brutal terms to refer to the dwindling assistance from Washington, D.C., utilizing such expressions as "fend-for-yourself federalism." The Governor of Michigan has bluntly stated that "Washington has gone from revenue sharing to revenue bleeding." A National Governors' Association official added the following: "The 'feds' have been living on the credit card for years. Now, by mandating us to do the things they can't afford, they're trying to use ours. The idea is they get the credit, we get the bills. But we don't have their ace in the hole: deficit financing," ibid., 28 August 1989, p. 8.
12. In Neal R. Peirce, "States: Dynamos of the Federal System," *State Government News*, December 1989, p. 23, the author asserts that the "1980s indisputably have been the decade of state governments. Those in doubt need only take a look at virtually any major domestic policy-making arena — welfare reform, early childhood care, education, environmental protection, homelessness, infrastructure, foreign trade promotion and health-care cost containment."
13. R. Scott Fosler, "The State Economic Role in Perspective," in R. Scott Fosler (ed.) *The New Economic Role of American States*, (New York: Oxford University Press, 1988), p. 17.
14. David F. Sullivan, "State and Local Government Fiscal Position in 1988," *Survey of Current Business*, February 1989, p. 20.
15. NASDA, *Directory of Incentives*, p. 25. The editors made this comment in reflecting on the major differences in findings between the first edition of this book in 1983 and the second edition in 1986.
16. Keon S. Chi, *Economic Development in the States: The States and Business Incentives* (Lexington, KY: Council of State Governments, 1989), pp. 1-9.
17. The UDAG program was to be phased out in September 1989 with plans to replace it with a federal enterprise zone program.
18. California voters provided this authorization when they approved Proposition 46 in 1986.
19. Robert Guskind, "Games Cities Play," *National Journal*, 18 March 1989, p. 634.
20. Chi, *Economic Development*, p. 1.
21. *City and State*, 3 July 1989, pp. 2 & 23.
22. Ann H. Elder and Nancy S. Lind, "The Implications of Uncertainty in Economic Development: The Case of Diamond Star Motors," *Economic Development Quarterly* I, no. 1, 1987, p. 36.
23. Bernard J. Frieden, "The Downtown Job Puzzle," *Public Interest*, Fall 1989, pp. 80-81.
24. Guskind, "Games," p. 635.
25. Ibid., pp. 635-36.
26. The Kentucky-Toyota episode is discussed in the *Wall Street Journal*, 9 June 1987, p. 33.

27. *The NASDA Newsletter*, 6 January 1989, p. 3.
28. Michael Smolens, "Enter the Enterprise Zone," *Golden State Report*, June 1989, pp. 26-28.
29. Elder and Lind, "The Implications of Uncertainty," p. 39, and *City and State*, 3 July 1989, pp. 2 & 23.
30. Guskind, "Games," p. 638.
31. *Economic Development*, 1 August 1989, pp. 1 & 5, the *Washington Post*, 9 January 1989, p. A9, and the White House, *Building a Better America* (Washington, D.C.: Government Printing Office, 1989), pp. 63-64. The higher figures are estimates from the U.S. General Accounting Office.
32. Robert Guskind, "Zeal for the Zones," *National Journal*, 3 June 1989, p. 1359. In 1989, among the 37 states and the District of Columbia, which had established enterprise zones, 24 states offered to businesses employer income tax credits, 22 wage or job creation credits, 21 sales tax relief, 19 credits for selective hiring, 19 regulatory relief measures, 16 property tax reductions, 14 direct loans, 11 investment credits for real improvements, 10 tax incentive financing, 8 credit for interest paid on business loans, 6 preferential access in the allocation of tax-exempt bonds, and 4 employee income tax credits. See Raymond C. Scheppach, Executive Director of the National Governors' Association, "Testimony before the Ways and Means Committee, U.S. House of Representatives, 17 October 1989."
33. Guskind, "Zones," p. 1359. Two other generally positive studies on the impact of enterprise zones are Rodney A. Erickson and Susan W. Friedman, *Enterprise Zones: An Evaluation of State Government Policies* (Washington, D.C.: U.S. Department of Commerce, Economic Development Administration, 1989), and New Jersey Department of Commerce, *The New Jersey Urban Enterprise Zone Program: An Evaluation*, July 1989.
34. One skeptical report was issued by the Congressional Research Service in June 1989 and entitled *Federal Tax Incentives for Enterprise Zones: Analysis of Economic Effects and Rationales*. Another study that is also skeptical is the U.S. General Accounting Office, *Enterprise Zones: Lessons from the Maryland Experience* (Washington D.C.: Government Printing Office, 1988). A report calling for significant modifications in the program, including more targeted public assistance, is Dan Y. Dabney's "Enterprise Zones and Their Relationship to Business Location Decisions," 1989.
35. Almost 75 percent of America's rural communities lost jobs and 50 percent lost population from 1980 through 1987. This was during a period when the nation as a whole created 13 million net new jobs. The poverty rate of the non-metropolitan population in 1985 was 18.3 percent, compared with 12.7 percent for city residents. See Charles Bartsch and Andrew S. Kessler, *Revitalizing Small Town America: State and Federal Initiatives for Economic Development* (Washington, D.C.: Northeast Midwest Institute, 1989), pp. 1-2.
36. These illustrations are found in John DeWitt, Sandra S. Batie, and Kim Norris, *A Brighter Future for Rural America? Strategies for Communities and States* (Washington, D.C.: National Governors' Association, 1988), p. 61.
37. These subsidies are computed on a "life-of-loan" basis. See the Executive Office of the President, Office of Management and Budget, *Major Policy Initiatives: Fiscal Year 1989* (Washington, D.C.: Government Printing Office, 1988), p. 37.

38. *Governors' Weekly Bulletin*, 14 April 1989, p. 1.
39. California World Trade Commission, *Newsletter*, Spring 1989, pp. 1 & 3.
40. *Governors' Weekly Bulletin*, 15 December 1989, p. 3.
41. Peter K. Eisinger, *The Rise of the Entrepreneurial State* (Madison, WI: University of Wisconsin Press, 1988), p. 296.
42. Ibid., p. 333.
43. John DeWitt, *Shifting Responsibilities: Federalism in Economic Development* (Washington, D.C.: National Governors' Association, 1987), pp. 69-70, and Roger Wilson, *Economic Development in the States: State Business Incentives and Economic Growth: Are They Effective? A Review of the Literature* (Lexington, KY: Council of State Governments, 1989), p. 3.
44. Public Securities Association, *Facts on Tax-Exempt and Taxable Municipal Bonds*, May 1989, p. 1.
45. These savings were calculated by using the PSA's computation of a 2.65 percentage point differential in 1988 between Moody's average A-rated tax-exempt municipal bonds (7.59 percent) and taxable A-rated corporate bonds (10.24 percent) and assuming the life of the bonds would be at least 12 years. In the mid-1980s, the average maturity for small-issue industrial development bonds was about 14 years and for other industrial development bonds about 20 years.
46. In 1988, almost $3 billion in long-term taxable state and local issuances was recorded, with over $200 million going for industrial development and economic development purposes. See Public Securities Association, p. 9.
47. The President's Commission on Industrial Competitiveness, *Global Competition: The New Reality*, vol. 2 (Washington, D.C.: U.S. Government Printing Office, 1985), p. 205. Not everyone agrees with these statistics. Mike Farrell, chief of data analysis and planning for the foreign trade division of the U.S. Census Bureau, estimates that 2,500 or even 25,000 firms account for 85 percent of U.S. exports, but admits that there is a glaring lack of reliable trade statistics. See the *San Francisco Chronicle*, 6 November 1989, p. C3.
48. For a more detailed treatment of economic development strategies, consult Fosler, "Conclusion," in *New Economic Role*, pp. 312-29.
49. As Eisinger insists in his book (p. 4), "[q]uestions of national economic efficiency or well-being are often lost in the competitive struggle to achieve local prosperity and security." R. Scott Fosler adds, "there needs to be a more aggressive effort to integrate economic policy among state and local governments, and among neighboring states, to focus on the needs of regional economies" in "State Economic Policy: An Assessment," *Business in the Contemporary World* I, Summer 1989, p. 96. Fortunately, the National Governors' Association, some regional groups such as the Western Governors' Association, and some local groups such as the Mid-South Common Market are beginning to focus their efforts on greater regional coordination and cooperation. For example, consult Jerry Levine, *Going Global: A Strategy for Regional Cooperation* (Denver, CO: Western Governors' Association, 1989).
50. As Dennis O. Grady suggests in his article, "State Economic Development Incentives: Why Do States Compete?" *State and Local Government Review* 19, Fall 1987, p. 93, "because of the states' balanced budget requirements, reducing business taxation requires decreasing services or increasing other consumer-based

taxes, actions which raise serious questions about the social equity of the entire business incentive system." In the *Economist*, 18 February 1989, p. 28, the editors refer to subnational governments providing funds to persuade industries from leaving as "protection money."

51. See Eisinger, *The Rise of the Entrepreneurial State*, p. 222.
52. This anti-takeover strategy was used by Federated Department Stores against Canadian-based Campeau, Farmers Group Insurance against British-based BAT Industries, and Koppers against British-based Beazer PLC.
53. Quoted in Andrew Anderson and Alan Rugman, "Subsidies in the U.S. Steel Industry: A New Conceptual Framework and Literature Review," Working Paper no. 14 (Toronto: Ontario Centre for International Business, October 1989).
54. Gary Hufbauer, "A View of the Forest," in *Subsidies and Countervailing Measures*, World Bank Discussion Paper no. 55, ed. Bela Balassa (Washington, D.C.: The World Bank, 1989), p. 16.

A British Columbia Perspective — Panel Remarks

Lorne Seitz

Earlier, much of our time was spent dealing with the broader issue of trade policy objectives. We're now turning somewhat more towards trade and investment development strategies and that's what I'm going to concentrate on. But perhaps I might just make one comment on the issue of provincial involvement in trade policy. The 1990s is going to be quite significantly different from the '60s, the '70s, or even the '80s in terms of provincial involvement in trade policy decision-making in Canada. And that, I think, is a reality. It's a question of how we structure that involvement. I suppose I just might wish to remind all of those, particularly our friends in Sussex Drive, of the old prayer "Lord, give me the strength to change those things I can, the serenity to accept those things I cannot change, and the wisdom to know the difference."

Before I move on to some thoughts on the issue of trade and investment-development strategies, perhaps just a comment on Earl Fry's paper. I thought his analysis of U.S. involvement was particularly good. On the investment front, it strikes me that the U.S. states are much more aggressive and much more active than are Canada and Canadian provinces. On the trade front, I think it's the other way around. Both the federal government and the provinces are much more aggressive than are the U.S. states. On the investment incentives front, it seems to me that the states put much more emphasis upon tax incentives than we do here in Canada. We tend to basically put all of our incentives on grants and loans and very little on the tax-incentive front.

Let me just turn to investment strategies. The first thing we have to ask ourselves is what are we really seeking to accomplish when we attempt to attract foreign investment? What are we looking for? Are we looking for capital? Do we need foreign capital to achieve our economic objectives? Are we looking for technology? Are we looking for investment that gives us access to international markets? Are we looking for entrepreneurial skills? Are we looking for economic diversification, particularly resource upgrading? I think that some might say we're actually looking for all of them, and perhaps to some extent we are. But if you had to priorize them, where would you put foreign capital? I would not put it close to the top of the list in terms of the reasons why we would be out there looking for foreign investment.

In terms of investment development efforts, to some extent one needs to look at the question of strategy. Is the strategy one of "come one, come all" from anywhere and any sector? As an investment policy, that approach is an appropriate policy for Canada. But as a strategy, an investment promotion philosophy, is that what we should be adopting? Should we adopt a reactive strategy where our investment promotion thrust is of a generic nature and then respond to the marketplace, respond to companies that express an interest and work with companies at that point? Or do we approach investment promotion with some concept of focus, some concept of targeting in areas where we feel that there is a particularly real opportunity and where we believe we have a real competitive advantage? To a very large extent one needs to ensure that the environment is in place to attract investment, but I don't think, certainly from the point of view of provinces, that we can just leave it to a reactive approach in terms of an investment development strategy. In the case of British Columbia, I believe that we can logically identify particular areas where there are real opportunities. Some of those opportunities relate to the resources that we have in hand and the need to upgrade and add value to those resources within the province. So we think that we can, to some extent, target. That's very different than picking winners and losers. But we do feel that there is an opportunity to identify particular opportunities and aggressively and proactively attempt to find investors for those opportunities.

The other issue, and particularly in the age of globalization, is where should agencies, government agencies, place their emphasis? Do we basically look at the large hits, concentrate on a few large projects and let the marketplace deal with the rest? Or do we put more of our effort into some of the smaller investments, a greater number but of a smaller nature? Certainly the large ones make the greatest news, but in fact the smaller ones may be somewhat more achievable and meaningful in the long run. And in that sense, that does bring into play from our point of view, the business immigration program. We see that program as being an investment program, an investment program with the immigration element being somewhat secondary to it. In the case of an investor under the business immigration program, he or she is an individual who wants to accompany their investment and manage it themselves. That's how we look upon that program. The business immigration program has got a bit of negative publicity recently. I think that negative publicity has tended to be focused on the small part of the program, not the large part. The small part being the investor category that advises investing $250,000. We speak in terms of $250,000, of course, in British Columbia, we're not one of the seven provinces that can achieve an investment at the $150,000 level. But, it focuses on foreign capital only. Many of these other objectives that one might wish to achieve from foreign investment are not accomplished by the investor category. And the negative publicity tends to be very much focused on that investor category, the view that the program sells citizenship, sells a passport for $250,000. Of course, in most cases investors can get back most of their investment at the end of three to five years. As a result some say, What is it costing, $25,000 a year?

The large part of the business immigration program is the entrepreneurial program and that program addresses more of the objectives that we should be attempting to achieve through investment. The objectives that relate to entrepreneurial skills such as: market intelligence and, with that, market access; technology; particular sector needs, in our case, for example, value-added wood products, and the development of that industry in our province. While they may not be big and in many cases are relatively small investments, they can perhaps be somewhat more permanent because the individual is making a lifelong commitment to accompany that investment, to live here and manage the investment and thus offer significant growth potential.

So I think that the business immigration program is very much an integral part of our overall investment strategy and investment program. One of the things that we're now looking at is a linkage between the capital of the investor category with some of the skills that are brought by people in the entrepreneurial category. As an example, we might put together Hong Kong capital in the investor category with entrepreneurial expertise from a German in the value-added wood sector. We're looking at the possibilities of being able to provide some of those linkages between the two sides of the investment program.

On the federal-provincial front, one needs to look at the role of a national investment-promotion program versus regional and provincial investment-promotion programs. Can a national agency promote the particular interests of a region, particularly if the investment is somewhat flexible in terms of location? There are certainly some investments where there is a logical location for that investment and it really would not make a whole lot of sense to go elsewhere. But there are quite a number of investments where the location could be somewhat flexible, could be in any one of three or four different locations. Where does that leave the people of Investment Canada? How do they deal with that issue other than on a straight reactive basis pointing out all the opportunities that might exist for that specific investment in any particular part of Canada?

What is the role of provincial-regional investment development agencies? To what extent can we work together with federal agencies? And what is the specific role for all of us? The environment for investment in Canada or British Columbia or anywhere else tends to be very much focused (in the eyes of the investor) on what is the environment for investment in Canada as a whole. Logically, that issue has to be something that the national agency addresses in a broad generic promotion program. On some of the specific projects there is a much greater role for provincial and regional organizations.

On the incentive front, I agree with just about everyone here that it really is a "mugs" game to be getting involved in the kind of bidding wars that exist. But I don't think we will achieve all that much by just doing a deal within Canada. Where is the competition for investment? If we just look at it from British Columbia, for example, where's the competition for investment in British Columbia? Is it Alberta? Is it Ontario? I think to a larger extent it's Washington and Oregon. So, from my point of view, if we only deal with the northern side of the border in addressing this question of incentives, we're not going to achieve all that much. I think we have to deal within a North American context and I guess if we've got any chance at all (and Earl Fry has wished us good luck on all of this) of addressing that problem, it has to be in a North American context.

Let me turn to trade development. To some extent, we've been talking about this question of a broad, large strategy of market diversification. Coming from British Columbia, I'm sure most people might think that the logical approach we would take is to say, "yes, absolutely, we have to diversify markets and because we concentrate on Asia Pacific so much now, logically the big trade development strategy should be Asia Pacific." But I'm not sure it should be. I don't know whether it's possible and I don't think it is all that wise to attempt to develop a broad, big strategy that says we should be diversifying our markets and our diversification should be to Asia Pacific or to Europe or wherever else it might be. It reminds me of the so-called Third Option back in the 1970s. It tended, I think, to be quite a failure. And I think it was a failure because it tended to be driven from the top down, a broad policy decision that didn't relate all that much to where the people who actually sell products, the companies, felt the opportunities were and where they wanted to put their emphasis.

We have to be awfully careful about developing large, broad trade development strategies that do not reflect the capabilities of the private sector and where their particular interests are. We need to look at particular products and where the logical markets are for those products. We also have to look at the nature of our exporting community. It just doesn't seem all that logical to take somebody who has hardly exported before and introduce them to exporting by taking them to Hong Kong or Japan. It just doesn't seem to me that's the appropriate first step to take. And to a very large extent, the exporting community in British Columbia, if you take out some of the very large companies, particularly those in the resource sector, what you've got left is a whole lot of small- and medium-sized companies who really don't have much expertise in trading. So we've got a great deal of work in front of us first of all to introduce exporting in the development of new markets to people in that category, assist them in acquiring some of the skills and then introduce them to new markets. Stuart Culbertson has talked about the fact that if you look at our total exports from British Columbia, it's about neck and neck, 41 percent United States, 41 percent Asia Pacific, and about 15 percent Europe. But if you look at the fully manufactured goods and the destination of those markets, during the last ten years it has stayed constant — 76 percent U.S. in 1980, 75 percent U.S. in 1989. Yes, Asia Pacific has grown quite dramatically. Japan, for example, took 2 percent of our value-added exports in 1980, but took 6 percent in 1989. So there certainly is growth there. But to logically look at where the opportunities are for many of our manufactured exports from British Columbia to a very large extent they still tend to be the United States. In my view, that is the market we need to introduce our new exporters to in the first instance, not to Japan and Hong Kong, but first of all to the United States. When one deals with the broad issue of a trade development strategy, to me a trade development strategy is something that tends to be a bit of a combination of much smaller strategies, much smaller targeted strategies that relate to particular products and to particular markets for those products.

If you want to look at a trade development strategy for Canada, I think you also need to look at the differences that may exist between trade development strategies for various parts of Canada as opposed to Canada as a whole. In our case, for example, a trade development strategy for British Columbia would focus first of all on the western part of the United States and second on Asia Pacific. That may not be the same kind of a strategy that one would adopt for Ontario or the Atlantic provinces. As a result, at the national level one has to be somewhat cognizant of and cautious in producing a trade development strategy for Canada as a whole because there are regional trade development strategies that might be somewhat different than those for Canada as a whole.

We need to also take a new look at the respective roles of the federal government and the provinces in trade development. I agree with Murray Smith that we should not be overly concerned if there is an element of duplication. But on the other hand, I don't think we should simply accept duplication, just throw more resources at it and not worry too much about attempting to refine the process. Right now the cooperation is good from our point of view. The cooperation is good, but is the structure efficient? Within that existing structure we have very good cooperation but is it efficient? We tend to run parallel operations. For example, the federal government runs regional trade development offices across the country. Everywhere across the country the federal government has international trade centres and all of the provinces have trade development activities at the provincial level. Offshore, the federal government has a large trade commissioner service network of international offices and many of the provinces also have international offices. I think that they can be complementary, but I do think we need a refining of the process that addresses where the federal and provincial strengths are in this equation. And I think that there is a bit of a demand-supply relationship. The federal government with its international presence can offer a great deal of market intelligence, it can offer onsight organization of trade development initiatives — that's the demand side of the equation.

The provinces are in much closer touch with the business community back home. The provinces have the ability to be much more efficient in organizing and mobilizing the export drive on the supply side from the home market to offshore. In a former incarnation, I promoted a concept that said that the federal government should close down their regional trade promotion offices and call upon the provinces to deliver federal trade information and trade programs. And on the other side of that equation, the provinces should get out of an international trade presence. If there are any offices for provinces abroad they would be for reasons other than trade development. And, frankly, I still think that's something that we need to look at. I'm not suggesting that every provincial office offshore would close, but I do think that we could rationalize activities and perhaps, certainly on the provincial side, achieve some economies by not attempting to be involved in trade development offices abroad. There may well be investment reasons why we might want to have offices abroad, and in the case of Quebec there certainly are immigration reasons why they might want to have offices abroad, but I do think that there is an ability for us to exercise greater efficiencies and economize.

Finally, let me raise the question of how governments in Canada finance these trade development initiatives. We spend a great deal on trade development activities, much more per capita than does the United States. Should we continue at that pace? The answer is yes. I agree with Murray that if we are going to diversify our markets, if we're going to diversify our economy and introduce new types of products into the scheme of things, those products and services logically have to be based upon an international marketplace. We don't have a large enough domestic marketplace to justify new product development. And that's going to take a fair amount of trade development effort. But how do we pay for all of these efforts? Do we finance it out of general revenues as I think we all have been doing to-date? Frankly, in this and for a lot of other government services, as one moves through the 1990s, I believe that there's going to be a move away from financing a number of government services directly out of general revenues. There are probably two broad options that we might want to look at. One is the fee-for-service concept that is that being used by Australia, New Zealand, the U.K., and to some extent the United States, where a company pays a fee if they want to utilize the trade development services of government. The other is the compulsory levy concept that tends to be used in Hong Kong, Austria, and Germany in various forms, where every company pays a compulsory levy, either as a small fraction of a percent of all of their exports or as a general business fee some of which goes towards trade development activities. Those are the two broad options. If we're going to be looking at new ways of financing trade development, my tendency is to look towards the latter option, the compulsory levy, because we need a proactive longer term trade development strategy rather than the very short-term strategy that will result from a fee-for-service concept.

We may also need to look at new vehicles in which the private sector has a greater say in determining trade strategies, particularly if one introduces the concept of compulsory levy. I think the private sector is going to demand a greater say in how those funds are spent and what will be the direction of trade development activities. Some of you, I know, are aware of the new organization we've established in British Columbia called the British Columbia Trade Development Corporation. It's a first small step in this direction. I wouldn't call it privatization, I wouldn't even call it commercialization because it is primarily funded by government, but it does operate outside the ministry structure. It does have a private sector board of directors and it does have a staff that comes with a background of trade development expertise in the private sector. Whether that's a model for other provinces or for the federal government, I don't know. Even in the case of the British Columbia Trade Development Corporation, I expect it to go through an evolutionary process. But I do think that we need to look at these new approaches in terms of structures, in terms of financing, and also with respect to the federal-provincial division of labour.

American Industrial Policy in the Early Years of the "Silent War"

James D. McNiven

Introduction

The most interesting facet of the ending of the Cold War in 1989 is not what is happening to the "loser," the USSR, but what is happening to the "winner," the United States. The struggle itself is reminiscent of the Peloponnesian War between the Spartans and their allies and the empire of the Athenians. The end of that conflict saw mutual exhaustion and the rise of Macedonia, until then a peripheral power, which extinguished Greek independence.[1] In some respects, both the U.S. and the USSR have exhausted themselves in a contest that neither could win on the battlefield. Nuclear weapons alone guaranteed that victory was impossible.

Exhaustion is perhaps the wrong way to look at the situation. These are more changeable times than Greece in the fourth century B.C. Instead, we may more fruitfully compare the situation to that of two champion arm-wrestlers who have been unable to best each other. When they realize that the spectators have all gone off to play and watch some other sport, they stop and find themselves left with strong arms that may not be particularly useful in a different kind of contest.

Ira Magaziner and Mark Patinkin have written a book about this new contest, called *The Silent War*.[2] The book covers much the same ground as a dozen others: what is most engaging is the title. The Silent War is the contest between countries for economic influence. It is a complex struggle that engages all parts of economies and governments. It is not really about military power and ideology, though these can play a part. It is instead a contest among states over adapting to the headlong process of globalization that has dominated the 1980s and will continue through the 1990s.[3] No one state today can control the process and those that try to resist change on a broad front find their very existence threatened by consumer/citizens who resent being denied the lifestyles of the more successful. East Germany is perhaps the extreme case in point.

The aim of this paper is to explore the Silent War in its general context and then to discuss more narrowly American reaction to its emergence from an industrial policy point of view.

From Cold to Silent

In the 1970s, Andrei Amalrik wrote a short tract entitled, *Will the Soviet Union Survive Until 1984?*[4] Unfortunately, he never lived to see his prediction come true. The date in the title was an obvious allusion to George Orwell's novel of world totalitarianism and the thrust of Amalrik's piece was that the USSR was too unstable to last. We now know that the USSR and its empire were not much more than a military shell by 1984 and that the Soviet system could not be sustained much after that date.

The reasons for this state of affairs were not correctly outlined by Amalrik. In fact, so soon after the end of the Cold War, no one really understands in detail what went wrong for the Soviets. My own feeling is that the USSR was unable to keep up with the technological dynamism of the competitive economies of East Asia, North America and Europe. It could produce some good technology for the military, but its systems of production and distribution could not adapt this technology for the broader civilian market. Trying to build technological dynamism with a single customer the size of the Red Army proved too costly to implement. The "Toshiba scandal," which involved the acquisition of a five-axis milling machine from Japan for use by the Soviet Navy in violation of the COCOM agreement is a case in point.[5] The machine was less sophisticated than one being installed in a plant in Nova Scotia at the same time. The Russians, with their very limited military "market," could not afford to develop such a machine, while the Western consumer market was already installing more complex devices. It should not be overlooked that the military in all of the East Bloc countries has not acted to prevent the communist systems from falling.

In 1985, Kenichi Ohmae, the head of McKinsey Consulting's Tokyo office, published an influential book entitled, *Triad Power*.[6] He argued that the triad of Europe, North American, and East Asia had in effect become the world economy and that other regions were little more than economic dependencies. His comments about Eastern Europe were limited to a few lines. The region simply did not count in the new contest. One way to see the changes taking place in Eastern Europe is as a move to try to catch up and become a fourth region in the world economy.

The U.S., the other major player in the Cold War, has the advantage of being a part of the triad already. Yet, many people are concerned with its relative performance since the mid-1970s. The large trade deficits of the latter 1980s have only provoked a louder reaction than various economic events since the first oil shock.[7] The end of the Cold War implies that the large-scale military complex built up since the end of World War II may not be all that necessary. It is a good question whether military production can be transformed into part of the more competitive civilian economy.

The problems of American adaptation are as much psychological as material. The prevailing view of America's place in the world has been one of absolute dominance economically. It is a throwback to the postwar days when the American domestic market was half the world's economy. Today this is not the case. In fact, the combined market of the EEC is larger than the American. No longer can the American government make American economic rules stick in the world marketplace, yet the tendency persists in most Americans to labour under the delusion that it can.

These problems are perhaps most obvious in the areas of finance and production. Much is made of trade in goods and services, yet the trade in money worldwide is as much as four times greater. Capital is vastly more mobile today as a result of computers and telecommunications. It is also less regulated than before, simply because it is impossible for national policy-makers to act fast enough to affect the global flow of capital and the effects of causing that flow to stay away from a country are too disastrous. The more-or-less unregulated capital markets began with the Eurodollar market during the Vietnam War and have expanded ever since, undermining national rules in even the largest states. In this context, it is an interesting question whether financial deregulation in the U.S. is a cause or a result of the new world capital market.

The production problem focuses on the asymmetry of American perceptions about trade and foreign ownership. As significant gains were made by Japanese and Europeans in the American market, demands grew for protection by American producers. Protection often let to foreign companies either setting up plants in the United States or buying out their American producers. This in turn has generated controversy as well.[8] At the same, time Americans have been vociferous about foreign protectionism and about restrictions being placed on American foreign investment. These double standards are quite familiar to Canadians.

All of this comes down to the nature of American industrial policy. Every country today has an industrial policy, just like every human being has a gender. It may be centred around low taxes and low exchange rates or may depend on arbitrary rules and subsidies or on some other mixture.

From the point of view of Canadians, the industrial policy implications of the material and psychological integration of the U.S. into the global economy has to be one of the most crucial questions facing us. Yet it is one that we have limited means to affect. The nature of our economy is such that we are tied to the American economy and we will prosper or not given how well this question is answered. Ironically, despite the stakes, Canadian policy-makers and others expend little time and few resources trying to understand the intricacies of the American political economy.[9] We content ourselves with the delusion that we can get all we need out of the *New York Times* and CBS-TV News.

The Elements of Industrial Policy

The term "industrial policy" is nowhere well-defined. In essence, it is concerned with the nature of government policy that helps or hinders commercial enterprises, whether privately or publicly owned. This definition is too wide, however, and could include almost everything government does. Instead, a narrower definition is preferred, that tends to focus on the international competitiveness of firms, especially manufacturers. Industrial policy therefore focuses on the problems and opportunities faced by those firms in a country that is engaged in international trade or subject to international competition. For the most part, these are manufacturers. Industrial policy is also seen in a positive mode, that is, it is a collection of sub-policies that taken together, try to improve national competitiveness.

Those who discuss industrial policy often present it in terms of its being the "third leg" of overall economic policy, complementing fiscal and monetary policy in this regard. Rightly or wrongly, industrial policy is not seen as having the specificity or concreteness ascribed to the other two "legs." There are too many potential elements involved in industrial policy to allow it to be as cleanly defined a term as the other two.

The effects of industrial policy are also not as tangible as those of fiscal and monetary policy. According to Hiroya Ueno:

> Unlike traditional fiscal and monetary policies, industrial policy demonstrates no clear relationship between its objectives and the means of attaining them. Its conception, content and forms differ, reflecting the stage of development of an economy, its natural and historical circumstances, international conditions and its general political and economic situation, resulting in considerable differences from nation to nation and from era to era.[10]

In keeping with this sentiment, an argument can be made that today's concern over industrial policy has a different tone and approach from past examples. The primary focus of industrial policy through much of the past century has been around the development of import-substituting industry. In the 1920s, Turkey and Argentina tried to develop autarkic regimes that protected domestic production at almost any cost. The aim was to produce a "full-service" economy in these countries. U.S. domestic competition policy and tariffs through the first half of this century may be seen in a similar light. French and Russian economic planning were also primarily oriented towards import substitution.

Today, the focus has shifted to the role of various countries in the world market. There is no pretence that a country can absent itself from the world economy and still keep up with the rest of the world at the same time. Technological change has overcome many national barriers, since often products cannot be easily duplicated, especially given the investments needed to produce the technology. Specialization in technology is more and more forced upon nations and they are increasingly forced to trade for goods they are unable to produce. Secondly, technological change has come upon the modes of production, making it increasingly necessary to construct factories to produce on a scale that outstrips any local demand. The economics of scale argue for "world" products, not national ones.

Industrial policy today is an attempt to respond to this new environment. To export is to demonstrate competitiveness. Conversely, any productive facility that is or wishes to be competitive has to strive to open export markets. It is impossible to say whether the liberal trading regime under the GATT led to the technological development of world-scale plants or whether the technical practicability of producing on a world scale led to the liberal trading regime. At any rate, all discussions of industrial policy today have at their core a concern over competitiveness as it is defined, not on a domestic scale, but in the international scene.

In the United States, this overall concern may be broken down into two perceived challenges and two potential responses. The first challenge is that of ensuring that domestic industries are organized, led, and financed in such a way as to assure their being competitive with their equivalents in the rest of the world. This is the "domestic" challenge. The "foreign" challenge is to make sure that these competitive American industries have few or no roadblocks to their penetration of foreign markets. The two challenges are to some extent interlinked, but they are also amenable to separation. American firms can be competitive, yet be blocked from foreign markets. American firms can be uncompetitive and unable to penetrate foreign markets. Or they may be both uncompetitive and subject to barriers in any case. The ambiguity lends itself nicely to political debate and formulae.

The responses to these challenges fall into two broad categories. The first type of response is to claim that the free market system will sort out the problem and that in a situation where both the domestic and international scenes are cleared of barriers to growth and productivity, American industry, or at least a good part of it, will hold its own. This may be categorized as "passive" industrial policy. The second type of response arises from the feeling that the domestic scene is so full of impediments to productivity and the international scene is so fraught with subtle and sometimes impenetrable barriers that only the coordinated use of political power can overcome them. In this view, the free market solution is both idealistic and naive. Political management is required in an "active" industrial policy.

The Trade Shocks and U.S. Reaction

Export performance has traditionally been seen as a proxy for national strength and competitiveness. Strong countries export and weak countries import. The decline in American trade receipts in the early 1970s was partially dismissed as a simple result of commodity price increases, especially in oil, that could be corrected through conservation, new energy technology and the recycling of petro-dollars from the rich, though underdeveloped, economies of the oil exporters. No one really attributed the movement of commodity prices to a changed order in the strength of nations.

This was not the case with a second shock that took place after 1979. Rising imports of manufactured products, especially automobiles and high-technology consumer and other products were not the result of some world price anomalies, but were due to the increased competitiveness of other, relatively developed countries. This constituted a more direct threat to the American perception of itself in the world.

The impact of foreign imports on the American economy in this later period came in two stages. First, in the late 1970s came the penetration of the American economy by significant volumes of foreign manufactures, especially in the automotive field. This was paralleled by market penetration in electronic consumer durables, such as television sets and stereo equipment, as well as increased sales in other durables, such as construction equipment and motorcycles. The effect of this penetration on the whole American market was relatively small, but it came in market areas that were quite sensitive to Americans.[11] The United States had traditionally seen itself as the originator and major market for automobiles, so the rising market share of foreign imports, caused in part by their relative fuel efficiency, almost seemed an affront to national pride. What was worse was that Americans themselves, acting as consumers, created the demand for these imports.

This sensitivity was compounded by the effect of internal shifts in domestic production practices. Not only were jobs being lost to foreign competition, but new investment was moving from northern Rust Belt locations into the south and west of the country, compounding the problem. As well, technological change in many industries meant plant closures and unemployment in heretofore large-scale and well-paying industries.[12]

After 1983, the problem of foreign penetration of the American market shifted. Many factors, such as an overvalued dollar and the fruits of underinvestment in research and development during the previous decade, led to a decline in American exports and, by a normal process, to a huge trade deficit. This time, the problems were not so much ones of worker dislocation and affronts to national dignity as a growing concern that the foreign financing of the trade deficit and the federal fiscal deficit could lead to large-scale foreign ownership and/or an oppressive debt load.

To many, the problems of the post-1979 period and the post-1983 period were different manifestations of the same phenomenon. In both cases, what was perceived to be a free and open market in America was set upon by foreign governments engaged in a new form of mercantilism, an idea that had supposedly fallen into disfavour after the middle of the nineteenth century.

Now, it seemed neo-mercantilist foreign governments had developed webs of subsidies and policies designed, first, to penetrate important parts of the domestic American market and then, second, to prevent American exporters from entering their own markets with their presumably competitive goods.[13] "Fair trade," in this scenario, meant that all countries had to abandon policies that distorted markets, or America had to develop an industrial policy that could match those of its competitors. Success, in either case, could be measured by the narrowing of trade imbalances with individual countries.[14] The response of the Reagan administration was to try to eliminate barriers and restrictions, while hoping that tax policy and deregulation would be enough to restore corporate competitiveness. The response of the State governments was to explore more active industrial policies as part of an overall activist economic development thrust.

Explanations and Ideas

There are a number of approaches that try to explain the events of the 1980s and to offer some ideas to American policy-makers about their possible resolution. Three will be explored here: the notion of the trading state; the globalization of markets centring on the so-called "triad" of East Asia, North America and Western Europe; and the problem of national competitiveness.

The Rise of the Trading State, by Richard Rosecrance, offers an approach to the export problem that is grounded in history.[15] Rosecrance suggests that in the milieu of international relations, there have been two major impulses: the first towards the accumulation of territory that results in a huge mass market and source of materials; the second, the accumulation of trading policies, intelligence and strategy that enables smaller nations to gain power in a more dynamic context. Czarist Russia and medieval Venice may be taken as polar examples.

The value of Rosecrance's ideas lies in the notion that international power may be pursued in more than one fashion. In effect, he suggests that the paralysis of the Cold War between two territorial powers, the U.S. and the USSR, has allowed others, such as Japan, the "four dragons" of East Asia and West Germany, to use trade policy and technical innovation to carve out significant niches for themselves in the world's power structures. Their ability to do so has led the world into a new time of turbulence. By forcing the pace in technological innovation and marketing, they have changed the economic "game." Nevertheless, if we apply the lessons of Edward Luttwak's recent book on strategy to the pseudo-warfare of competing industrial and export initiatives, we can expect that the stunning success of the trading state approach will soon be countered by its victims.[16] Commentators, such as Lester Thurow, have offered their solutions, many of which are imitative of what they think the Japanese are doing.[17] Even so, there is no doubt that the rapid shift to a technologically-intensive economy in much of the developed world has contributed significantly to both the erosion of traditional Communist economic methods as well as to the reformulation of the American economy in the 1980s.

A second approach to the export problem is suggested by *Triad Power*, by Kenichi Ohmae.[18] The triad consists of the three major economic powers of Japan, the United States and the European Community, along with their associated states on each continent. Ohmae's thesis is that the triad's major markets are within itself, and that this bloc is not only economically dominant, but is creating a truly global economy. The industries of each power are beginning to penetrate the others' markets, products are becoming standardized, financial flows are global and inflation rates and other monetary standards are moving towards harmonization.

The problems afflicting America, from this viewpoint, are ones of adaptation to this international economy. Where American firms have been accustomed to keeping their domestic economy to themselves while penetrating others, that can no longer be the case. All penetrate all. As this process goes on, the turbulence in each part of the triad will rise and fall as adjustments are resisted and then accepted. The concerns raised in books like Susan and Murray Tolchin's on foreign ownership in America should, in the triad view of the world, be seen as normal concerns about adjusting to the integration process.[19]

Third, after the 1986 Congressional elections, the notion of an American industrial policy, which had seemed to be put to rest by Reagan's 1984 victory, was resurrected under the guise of "competitiveness."[20] National competitiveness is derived from traditional notions of comparative advantage. By allowing firms located in foreign countries to gain positions of lowest cost producer, or best product designer or best marketer, America is viewed as dissipating the strength it enjoyed after World War II. By focusing on policies designed to improve competitiveness of American firms in the international marketplace, this process can be reversed. Competitiveness therefore leads to the achievement of national security goals as well as to a higher standard of living.

Two studies exemplify the competitiveness literature. In 1983, President Reagan appointed The President's Commission on Industrial Competitiveness, which reported in January 1985.[21] In its view:

> Today, imports and exports represent twice as large a portion of our gross national product (GNP) as they did just two decades ago. Almost one-fifth of our industrial production is exported, and fully 70 percent of the goods we produce compete with merchandise from abroad. Quite simply, no longer is there a truly domestic US economy.[22]

and:

> Competitiveness is the degree to which a nation can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining or expanding the real incomes of its citizens.[23]

The Commission made four broad recommendations that incorporated many more specific ones. The four were:

- create, apply and protect technology;
- reduce the cost of capital to American industry;
- develop a more skilled, flexible and motivated workforce; and
- make trade a national priority.[24]

These recommendations focused on problems of technology and productivity, though the comments and definitions above also implied a concern that American trading partners might not be allowing free and fair markets, thus inhibiting whatever effects a competitiveness strategy might have. Bruce Scott and George C. Lodge, in their 1985 book, *U.S. Competitiveness in the World Economy*, note:

> The significance of our traditional national advantages is thus greatly eroded and our competitive position depends increasingly on *man-made* advantages. Competitiveness is more and more a matter of strategies, and less and less a product of *natural* endowments... Our government has not been a passive spectator or neutral arbiter of market forces; instead it has steadily steered incentives away from work, saving, investment toward leisure, borrowing and consumption.[25]

To Rosecrance, the American trade problem is one of responding to an historical challenge between types of states. To Ohmae, the problem is one of adjustment to the forces of globalization. To the competitiveness advocates, the problem is one of redirecting national energies towards productivity and technology and arresting relative decline.

Industrial Policy and Trade

From an industrial policy point of view, there are at least four dimensions to the American trade problem. These are:

- the selectivity of the import penetration problem;
- the technology/development problem;
- the problem of management failure; and
- the shift from national to global products.

The import penetration problem is not a general one. Instead, the impact of imports has largely been felt in sectors of the economy that are seen as traditional American strengths. These are concentrated around consumer durables such as automobiles and electronics, and intermediate goods and equipment, such as steel and construction machinery. Even if the problem of the trade deficit had not arisen, the need to maintain such industries in order to maintain national security would have resulted in an outcry.[26]

Thus, the selectivity of import penetration merges concerns about national security, in terms of the ability to produce needed goods, with industrial policy ideas. Even if imports would improve the economic welfare of Americans, they would lose, or appear to lose, the ability to produce many goods if a crisis were to arise.[27] The fact that this scenario could only occur in a World War I or II context is beside the point.

The second problem relates to the nature of the American economy in the future. Without a production system that is diverse, the potential avenues to express American creativity and technological superiority would be cut off. The literature on industrial policy is replete with assumptions that the American genius lies in innovation.[28] Foreign producers, it is further assumed, have simply taken American innovations and turned them into mass products. Unless the country's manufacturers become more competitive, American technologists will simply find themselves producing ideas for foreign firms, or not producing ideas at all. Industrial policy must try to ensure that technology devised by Americans is effectively exploited by them as well, before foreign imitators can take the advantage.

A third approach taken by the proponents of an activist industrial policy is that of management failure.[29] American managers have failed to adapt to changing conditions. They have focused on short-run profit pictures and on domestic competition that behaves in ways familiar to all American management. Meanwhile, foreign producers have concentrated on long-term objectives, global market share and on new ways of marketing and designing goods. American managers have lost domestic and global markets because they have been unwilling to concentrate on production, preferring instead to spend valuable resources and time on financial manipulation. As well, the American policy concern for maintaining a high degree of domestic competition has neglected the shift to global competition. The difficulty of meeting the global challenge is compounded by antitrust provisions that distract American producers into sometimes pointless domestic competitive stances.[30]

The fourth approach has been to recognize the emergence of a global market dominated by global products. Traditionally, American multinationals have been prone to see the world market as having distinct national tastes, so national plants and designs were featured.[31] Emphasis was placed on overall financial and policy control from head office while leaving much of the marketing and design functions to local initiative. The genius of Japanese industry in the 1970s and 1980s was to capitalize on the convergence of market tastes in all the developed countries by trying to produce consumer goods to a single standard.[32] As American producers adapted, they also began to move new production facilities offshore to take advantage of lower labour costs and other savings.

Producing global goods also helped to speed the "hollowing out" process of American firms. Production was detached from finance and marketing, so that a General Electric product, for instance, could be assembled in Singapore from parts produced in a dozen other countries and then marketed in the United States by an American company. The company might be doing very well out of the sales of the product, but manufacturing jobs in America would be reduced and the trade deficit aggravated by the global activity of this "hollow corporation."[33]

Conclusion: America Enters "The Silent War"

For over 40 years, the potential conflicts between the multinational corporation and the nation-state have been discussed by business analysts and political scientists. Recently, this potential has become heightened and the corporations appear to have gained the advantage, though possibly only on a temporary basis.

The coupling of international finance to modern communications and computational technology has allowed global production to proliferate. At the same time, communication technology has helped to forge the urban areas of the triad into virtually one large market. French historian Fernand Braudel noted that it took over a century after 1500 for tobacco usage to spread from the Caribbean around the world.[34] Today, the commercial introduction of a product can be made simultaneously in all the major world markets.

These developments have called into question the utility of national policy variations. Of what use is it to protect Russian central planning initiatives and structures when technological innovations can be introduced by the rest of the world in an unpredictable fashion with unpredictable timing with unpredictable results? Of what use are American policy measures to protect the diversity of the national production structure when both American producers and consumers elect to make and buy from abroad? The pace appears to be too fast for the world's slow-moving bureaucracies to react effectively. Yet, no one country can unilaterally move to slow down these processes because no one is large enough, or powerful enough, to effectively do so. As change continues in its neighbours, friends and enemies, it would increasingly see its own power eroded.

If it is not possible to control the pace or the vector of change that corporate competition has introduced into the global economy, the only alternative for the nation-state is to adapt to the new conditions and to institute policies so as to maintain or enhance its relative power. In the United States, this was tried in two different ways at two different levels of government in the 1980s. Under the Reagan administration, the federal government tried to set basic conditions by lowering inflation and tax rates and stay out of the way of American companies as they restructured to meet the challenges before them. This approach has had mixed success and failure. Some companies have prospered mightily, though there is a large trade deficit. The state governments have tried to force change in a more activist mode. They have generally moved to encourage more local corporate development, especially in technologically-intensive industries, and have become quite active in the area of export development policy. Again, the record is mixed. Often the efforts are too new to evaluate, and it is clear that the resources expended, while growing, are still small and their effectiveness remains in doubt.

America entered the Silent War as the Cold War was waning. It will take much of the decade of the 1990s to accomplish the necessary psychological and political shift from cold to silent. Meanwhile, there will be considerable turbulence as the policy options are defined and selected. Canada, because of our dependence on the U.S. market, will be intimately tangled in the debate.

NOTES

1. See, for instance, H.D.F. Kitto, *The Greeks* (Hammondsworth U.K.: Penguin Books, 1964), pp. 154-59.

2. Ira Magaziner and Mark Patinkin, *The Silent War: Inside the Global Business Battles Shaping America's Future* (New York: Random House, 1989).
3. The most successful attempt in fiction to portray life in the globalized twenty-first century has been made by a Canadian, William Gibson. See his *Neuromancer* (New York: Berkeley, 1984); *Count Zero* (New York: Berkeley, 1986); and *Mona Lisa Overdrive* (New York: Bantam Books, 1988).
4. Andrei Amalrik, *Will the Soviet Union Survive until 1984?* (New York: Perenneal, 1971).
5. "Big One That Got Away," *Economist*, 27 June 1987, p. 46.
6. Kenichi Ohmae, *Triad Power* (New York: Free Press, 1985).
7. Two of the more interesting shouts are: The MIT Commission on Industrial Productivity, *Made in America* (Cambridge: MIT Press, 1989) and Michael E. Porter, *The Competitive Advantage of Nations* (New York: The Free Press, 1990).
8. The foreign investment controversy in the United States appears to be going through the same cycle as it did in Canada between 1972 and 1984.
9. It is perhaps telling about the Canadian psyche that the Government of Canada will spend millions to encourage scholars in other countries to study in Canada but does not support a single Canadian program of American studies, policy or otherwise.
10. Chalmers Johnson (ed.), *The Industrial Policy Debate* (San Francisco: IPC Press, 1984), p. 6.
11. A useful statistical presentation of this argument is presented in The President's Commission on Industrial Competitiveness, *Global Competition: The New Reality*, vol. II, (Washington, D.C.: U.S. Government Printing Office, 1985), p. 17.
12. See, for instance, Task Force for a Long-Term Economic Strategy for Michigan, *The Path to Prosperity* (Lansing: Cabinet Council on Jobs and Economic Development, November 1984), chap. II.
13. One of the more sensible works is Ezra Vogel, *Comeback* (New York: Simon and Shuster, 1985).
14. Most versions of proposed U.S. trade legislation between 1986 and 1989 contained micro-trade provisions of this nature, as well as interesting explicit and implicit definitions of "fair trade."
15. Richard Rosecrance, *The Rise of the Trading State* (New York: Basic Books, 1985).
16. Edward N. Luttwak, *Strategy: The Logic of War and Peace* (Cambridge: Harvard University Press, 1987). Luttwak's concerns are the paradoxes and logic in war strategy, but his ideas are applicable to all competitive organizations.
17. See, for instance, Lester Thurow, *The Zero-Sum Society* (New York: Basic Books, 1980); and contributions by Thurow and Kevin Phillips in David Obey and Paul Sarbanes (eds.), *The Changing American Economy* (New York: Basil Blackwell, 1986); and Chapter 16 in Stephen S. Cohen and John Zysman, *Manufacturing Matters* (New York: Basic Books, 1987).
18. Ohmae, *Triad Power.*
19. Martin and Susan Tolchin, *Buying into America* (New York City: Times Books, 1988).
20. "The Clamour for Competitiveness," *New York Times*, 14 January 1987.
21. The President's Commission on Industrial Competitiveness, *Global Competition*

22. Ibid., vol. I, p. 9.
23. Ibid., vol. I, p. 6.
24. Ibid., vol. I, p. 2.
25. Bruce R. Scott and George C. Lodge (eds.), *U.S. Competitiveness in the World Economy* (Boston: Harvard Business School Press, 1985), p. 8.
26. Penelope Hartland-Thunberg and Morris Crawford, *Government Support for Exports* (Lexington, MA: Lexington Books, 1982) pp. 12-17.
27. The tenor of these concerns can be easily seen in both a concise and complex fashion in "U.S. Economy Grows Ever More Vulnerable to Foreign Influences," *Wall Street Journal*, 27 October 1986.
28. See, for instance, Peter Morici, *The Global Competitive Struggle: Challenges to the United States and Canada* (Washington, D.C.: National Planning Association, 1984). Unlike many other more inflammatory writers on this subject, Morici uses considerable data to make his point.
29. See, for instance, Ira C. Magaziner and Robert B. Reich, *Minding America's Business* (New York: Vintage Books, 1983); and Cohen and Zysman, *Manufacturing Matters.*
30. The President's Commission on Industrial Competitiveness identified merger provisions and research and development funding as two areas where antitrust provisions hurt American competitiveness. See *Global Competition: The New Reality*, op. cit., vol. II, pp. 85, 183.
31. Alfred P. Sloan, Jr., *My Years with General Motors* (Garden City, NY: Doubleday, 1963), chap. 18.
32. See, for instance, Ohmae, *Triad Power.*
33. "The Hollow Corporation," *Business Week*, 3 March 1986.
34. Fernand Braudel, *The Structures of Everyday Life* (New York: Harper and Row, 1981), pp. 261-62.

Session IV — Digest of Discussion

Stuart Culbertson, a panel member, led off the discussion with two questions for Earl Fry. Culbertson wondered if there was a trend towards the development of stronger consultative mechanisms between the federal and state levels to gather information on state subsidy practices. Fry pointed towards several developments in the consultative process in the United States that were encouraging. For example, the National Governors' Association has set up an International Trade Task Force, which meets on a regular basis with the USTR. In addition, Department of Commerce officials have been meeting with governors and state trade representatives seeking advice not only on what they would like to see in future negotiations with Canada over subsidies but also on the development of a list of some state programs that might be questioned by Canadian negotiators. The impetus for this increased consultation between the state and federal levels began with the Canada-U.S. free trade discussions. However, the degree of intergovernmental interaction remains far less than that which has been achieved in Canada.

Culbertson's second question dealt with the matter of procurement and whether the state governments would be willing to consider an agreement over procurement practices similar to that recently achieved in the EC. Fry noted that many state and local governments continue to spend hundreds of billions of dollars on the procurement of goods and services, and it seems unlikely that many of these governments are willing to change their current policies. Thus, it would appear that the impetus for reform will have to come from elsewhere.

A participant from the private sector offered some observations on strategic and organizational issues that Canada will have to consider in the "dog-eat-dog" world of global competition. The participant pointed to three major developments, which have occurred in the last decade affecting Canadian trade and investment practices: globalization, while not a new phenomenon, has witnessed an increasingly rapid pace in its development; the GATT system has evolved into a tripolar agreement between the three major players — the European Community, the United States and Japan; and there has been a marked trend towards more mergers and acquisitions and the development of strategic alliances in production and marketing in some industries around the world. In the current GATT arrangement, which the participant described as a "legal system of self-help," the weakness for Canada is its inability to form alliances with one or more of these major players when its interests are under attack. Since trade law transgressors are not fined under GATT, and nor has there been a history of collective action against such transgressors, the reality is that leverage on the international bargaining scene must come from the power of large markets, which Canada does not possess.

The bottom line for Canada, given the significant exposure of its domestic market to international forces and its limited industrial and technological capacity on a global basis, is that it has limited leverage and marginal influence on international decision making. However, it was noted that Canada has in the past maintained a considerable amount of manoeuvrability on the international negotiating scene. To ensure this continued manoeuvrability, the participant suggested that federal and provincial governments will have to work together at avoiding a cumbersome decision-making process that is still coloured with bureaucratic and political posturing over constitutional jurisdiction. He cited the softwood lumber dispute as an example of how the federal-provincial process did *not* work properly in determining a Canadian position that optimized all Canadian interests.

Bob Herzstein, drawing from his experience as the first Under Secretary for International Trade with the U.S. Commerce Department, noted that in the last ten years there has been a considerable devolution of trade promotion responsibility from the federal to the state level. In his opinion, such activity is more appropriately undertaken at the state and local level, but with federal financial support. Herzstein offered three lessons for Canada's federal system regarding international trade and investment. First, if you can separate trade promotion from trade policy, the potential for intergovernmental conflict is significantly reduced. Second, any decision-making process needs to be "clean and quick"; for example, the United States federal government has an advantage in that it has the power to "elbow out" the states, if necessary, in the decisions as to what issues shall be negotiated and what positions taken with foreign countries. Third, there is also a need to single out subsidies for investment in terms of efforts to reduce "beggar-thy-neighbour" competition.

Earl Fry, responding to an observation from Quebec International Affairs official Carl Grenier, concurred that agreement between the United States and Canada on what constitutes a harmful subsidy is difficult to achieve given the somewhat ideological stance of the Americans of viewing subsidies in a very narrowly-defined sense. In view of developments at the subnational level in the United States, Fry thought that the need for a more realistic and liberalized definition of subsidies was even more pressing.

Later in the session, a remark from the chair regarding Canada's role in multilateral trade negotiations elicited some comments from Jake Warren, a longtime representative of the Canadian government in GATT negotiations. Warren challenged earlier observations at the conference that these negotiations are now overwhelmingly dominated by the European Community-United States-Japan trading bloc triad, in contrast to the immediate post-WWII period when Canada was a more significant player among 12 or 15 more independently-acting countries. The rising prominence of large trading blocs, Warren contended, has not necessarily been associated with increased effectiveness for these major players in pursuing their interests at the negotiating table. In particular, he drew attention to the immobilization that has resulted from the longstanding and often bitter trade disputes between the U.S. and Japan as well as the seemingly irreconciliable differences between the European Community and the U.S. over agricultural subsidies. Moreover, the agenda for negotiations has been substantially broadened, increasing the need to make deals that involve smaller countries or "middle powers." With the heightened importance of establishing and maintaining alliances, a country such as Canada can still maintain a considerable degree of leverage in the processes to develop these alliances. As Warren remarked:

> Although it may well be true that at the end of the day, the big deals will depend on bridging these gaps between the triad, the fact of the matter is that a range of countries has had a rather larger role this time [in the Uruguay Round] and continues to have it in submissions of seminal papers and possible compromise solutions in the different subjects than was the case in either the Kennedy Round or the Tokyo Round.

V

Canadian Federalism: Meeting the Challenges?

Concluding Comments

Richard Simeon

The main purpose of the concluding session is to sum up our discussions and see if we can map out any directions for how we might adapt the institutions and practices of federalism to the challenges of the global environment.

My role is really to act as that of a rapporteur to the conference. I would like to make a few observations as a political scientist about how I see some of these issues and about what is said elsewhere and to suggest a few questions for further research and discussion.

The two basic points for this conference are: first, that federalism no longer stops at the border. Whether we think about how Canada projects itself to the world, or whether we think about how the world impacts on Canada, the border is essentially being rubbed out as far as federalism is concerned. Second, the pace and scope of change in the global environment is huge, and extremely hard to predict. This creates the imperative for an ability to be adaptable and flexibile even when the only thing we really know is that change is inevitable.

I would like to begin by underlining some of the things that Ivan Bernier and Gordon Robertson have said. There seems to be somewhat of an air of unreality in discussing federalism and trade when events going around us lead us to question whether we will have a federation that is functioning at all in the next few years. Resolving the constitutional impasse is a prerequisite for Canada's successful and active participation in the world. And this leads to my first set of points: that there are some direct links between the national debate on the Meech Lake Accord, and more generally the national debate on the maintenance of a federal Canada, and the global phenomena we are discussing here. The shifting Canadian position in the world produces changes in our own domestic political economy and both of those in turn interact with our constitutional difficulties.

First of all, the Canadian reality is that the global forces have an impact on an already highly differentiated national economy. Indeed, sometimes it seems difficult to know whether one can talk at all about a national economy in Canada anymore. It was mentioned that corporations no longer carry flags, that it is not easy to talk about national corporations. For Canada, I am not sure it is easy to talk about a national economy in any coherent sense.

So the global forces generate different effects, and different policy needs, for each region — each of which is inserted into the global and North American economies in different ways. These global forces almost certainly heighten regional differences; they also exacerbate regional disparities while at the same time constraining the ability of governments in Canada to address them.

The appropriate policy responses in one region are not necessarily appropriate in others. We hear increasing talk about the need for regionally distinct fiscal policy, monetary policy, industrial policy, trade policy, even regionally differentiated exchange rates. And if these observations are correct, then how do we develop national policies, whatever the process and division of powers? Do we even want or need national strategies? Would we be able to recognize a national strategy if we saw one?

Second, the progressive integration of Canadian regions into the global and North American economy is associated with declining proportions of trade and declining levels of economic integration within Canada. The result is that less and less does the economic well-being of one region depend on the success of others. Less and less is Canada the kind of mutual insurance company that Alan Blakeney once called it. Just to take one example: before the Canada-U.S. Autopact back in the '60s, auto workers in Oshawa had a direct stake in the success of the British Columbia forest industry, because how well it was doing was going to influence how many cars B.C. loggers would be able to buy. But now since the reorientation of the Ontario economy on north-south lines, Oshawa auto workers are pretty much indifferent to how well the B.C. timber industry is doing; they have little stake in its success. One possible long-term result of this relative decline of economic linkages within Canada is a decline of political linkages as well.

Again it leads each province to see itself as a separate entity and to pursue its own policies. It inevitably chips away at some of the cement of confederation. It means that it has become more important when we think about infrastructure in Canada to make sure that the infrastructure works well communicating from north to south — and there is much less need to worry about east-west communication. When we talk about restructuring in Canada we have to realize that the restructuring is often also a regional restructuring with all the conflict that implies. It is harder too when the capacity of the federal government declines.

With respect to regional transfers, it seems to me that when one shifts around the Canadian political economy tensions also increase. There is a big difference between an equalization dollar that goes from Toronto to Ottawa to Fredericton and then gets spent back in Ontario — that is, a dollar that circulates within the country — and that same dollar that goes from Toronto to Ottawa to Fredericton to somewhere else. Transfers then no longer help find the country; they are zero-sum. Again this begins to erode the commitment to regional sharing that was such an important part of the confederation bargain.

This declining interdependence within Canada also changes the framework in which we think of Quebec independence. If Quebec really is less and less economically dependent on the rest of Canada, then one of the main arguments made against voting "YES" in the referendum on independence in 1980, namely the argument about the economic risks associated with it, largely disappears. This may help explain the apparent changes in the views of many in the Quebec business community, and the recent spate of reports that suggest few if any costs to separation.

I think that that is a dangerous view to take, because that same global environment, which in some sense might make it seem more feasible to separate, is also highly sensitive to symbols and to political uncertainties. And it is certainly very hard to believe that there would not be very large repercussions if we were to find ourselves negotiating separation in the external world. Market reactions to the Meech Lake debate are just a small taste of what would be in store.

Global forces are also hugely affecting the meanings of national sovereignty and of independence. We seem to be in the twilight of the autonomous nation-state, and we need to rethink all the concepts like sovereignty associated with it.

Tom Courchene suggests that the major loser from globalization is governments. I would add labour as well, because the losers are those who are immobile and the winners are those who are mobile. With respect to federalism, I think that the largest loser from all of this in the long run is likely to be the national government. Its power is draining on the one hand to supra-national institutions and on the other to smaller local institutions. The main federal economic levers have become more and more constrained. This long-term erosion of the federal government is likely to come about despite the possible short-term increments to federal power through an enhanced Trade and Commerce or Peace, Order and Good Government clause. Again this decline really cuts two ways. It makes Ottawa less of an attractive pole for Canadians and less and less an effective actor for them. Therefore it makes disengagement easier.

But, of course, on the other side it also means that the provinces themselves, if they were more independent, would be highly constrained.

The one thing we know globally is that we are witnessing extraordinary fluidity and innovation in institutional forms. As I said, the traditional nation-state mould has been broken not just because of economic forces, but also because of changes in political attitudes. We are going to see more and more debates about institutional forms being played and replayed, whether we are discussing Quebec-Canada relationships or whether we are discussing the Canada-U.S. relationship or whether we are discussing regional alliances between Ontario and the mid-western American states or between British Columbia and the Pacific northwestern United States. There is going to be a whole lot of institutional innovation and experiment within the country and a lot of the language with which we have debated national unity in the past is going to change.

So, I think that globalization is at the heart of some of the most fundamental tensions within Canadian federalism. It has an impact on an already diverse society and economy. Globalization exacerbates, rather than blurs those differences. It is an enormous political challenge to redefine the meaning and purpose of Canada in such a global and constrained world.

To turn to the more practical problems this conference has addressed, the question is how do we best adapt our policies, institutions and processes to respond to the exigencies of this global environment.

It is important to underline that this means not only the capacity to project our interests effectively in dealing with international trade issues, but also the capacity in our domestic policies to enhance our competitiveness, our productivity and so on. We did talk about investment and trade promotion. We did not address issues like education, research and development, infrastructure and so on. These are, of course, also very important for intergovernmental relations, both now and in the future. Both levels of government have an important role to play in them.

As we think about coordinating federal and provincial governments, we seem to be under a double imperative. On the one hand is the desire and demand for unity and singleness of purpose — and lots of people have asked how we can speak with one voice abroad, how will we be more able to act quickly and decisively in the international arena, and so on.

On the other hand, it has been said equally often that we need to coordinate and respond to very different regional needs and governmental interests. These two imperatives are not at all easy to reconcile.

Broadly speaking, there are three possible models for structuring federalism in the international context. First is to argue that the message of globalization is that it creates an imperative to centralize — that federalism and all the fragmentation and pluralism is a kind of luxury that one cannot afford in this lean, mean competitive environment and that therefore we must look to strengthen the federal Trade and Commerce power, or expanding section 91(2), or enhancing the federal ability to implement international agreements. There are strong arguments for such a position: Canada is already a relatively small, relatively constrained international player. One presumably would not want to weaken it anymore by speaking with many voices.

As Robert Richards suggested, there may be some modest moves in this direction by the courts. But clearly, as he pointed out, any move in that direction is going to be limited and the likelihood of centralizing amendments of any fundamental sort seems remote. As the scope of international trade concerns are projected more and more into provincial areas of jurisdiction, the federal dominance in trade policy is more likely to decline than to grow.

It is interesting that no one so far at this conference has argued for the more centralist model — though several people have pointed to the costs of federal-provincial breakdown in areas like softwood lumber.

The second model is what one might call the decentralist one. If Canadian regional needs and interests are so different, why should each province not have its own trade policy? Why should we stick with just having them consulted? Why should we not go beyond restricting provinces to trade promotion, or to participating in federal decision-making. Why not allow them to be international economic actors in their own right?

In theory a case could be made for this. Trade policy would no longer be what could be achieved through compromise and consultation. Provinces would be able to make sure they could fight for exactly what they wanted. But that is not a realistic model. The big objections to it are that the international partners would probably not allow it; and that while we might have more international actors, they would also individually be weak ones on the international stage. Canada is a member of G-7; no single province would be.

So we come to the third, or default, option, the one we have talked about most: the collaborative or shared model. Trade policy as an intergovernmental partnership, whether that is a necessity that we have to live with, or whether it is a desirable outcome, the overwhelming message of this conference is that this is the model we have to work with.

Clearly much progress in this direction has been made in the Free Trade Agreement negotiations and in others. And while listening to the panel yesterday afternoon I was reassured to know that national reconciliation does not seem to be actually dead yet, that there were all sorts of friendly words going back and forth about how accommodating the federal government was being and how the provinces were, too. So maybe national reconciliation lives at least in some parts of our system.

The day when the Ontario trade minister had no part in negotiating the auto pact is long gone. It is clear that both provincial aspirations and provincial expertise has grown immensely. It is clear too, that the constitutional split between negotiation and implementation of treaties makes provincial involvement essential. If we are going to use this model in the future, we have to find a way to trade off or to link the whole question of provincial influence in negotiating internationally with the need to secure provincial compliance for deals once they have been done.

But clearly there are obvious problems in running this kind of collaborative model, as softwood lumber seems to show.

There is the whole problem of delay, of people tripping over each other, of lowest common denominators that are not really in the interest of anyone, of possible frustration for our trading partners. There is the problem of the kind of ad hoc nature of much of the consultation. While there may be all sorts of sweetness and light as a result of recent negotiations, there is no necessary reason at all that it will continue. Constitutional failure or the emergence of economic issues that are regionally divisive could easily sour the cooperation.

The most important thing that we need to do here is to clarify where, and in what circumstances, we should be along the continuum of intergovernmental collaboration. At one pole we simply talk about consultation — exchanging information, seeking the others' views, making sure you are communicating well and so on, but with the ultimate authorities still resting in one place. When most federal officials talk about collaboration, that is really what they are talking about.

At the other end of the continuum, the model is one of joint decision-making: with policy determined by formal intergovernmental agreement, with provinces actually at the negotiating table. Conference speakers ranged all the way along that continuum. But I think as we discuss formalizing and regularizing federal-provincial institutions, or creating permanent federal-provincial bodies, we need a whole lot of care in spelling out where we want to be.

In some areas, such as treaty implementation in areas of clear provincial jurisdiction, the joint decision model may be required. In other areas, we should be very wary of it and look for consultation but not look for governments formally to bind each other.

We also need a clearer delineation of the division of labour among governments. It is clear they do not need to do everything together. So we need to know more about, or think more clearly about, the areas where we think it is right and useful to give free rein to the provinces to act internationally. Where is it that we see real costs in terms of getting in each other's way and frustrating each other, and would want to restrain such activity? Is the distinction between trade promotion and trade policy useful in thinking about the relative roles here? Where do we gain from the competition among governments that federalism creates and where do we say that that internal competition has unacceptable costs in areas such as internal barriers to trade.

These are difficult issues but it is only when we have a sense of these roles that we can decide on the appropriate machinery.

To conclude, it is easy to throw up one's hands at the difficulties of doing trade policy in a country such as Canada with such diverse regional interests, and such a decentralized federalism. Indeed it is a challenge. I think it is worth recalling a response of a Japanese colleague on hearing a lament about the perils of Canadian diversity to fragmentation. "Everybody laments the characteristics of their own country, but don't you see all the strengths and resilience and innovativeness and opportunities for experiment that your diversity gives you, these aren't necessarily disadvantages at all. You should turn these disadvantages to advantages. Our problem is we are far too homogeneous! You think that gives us a wonderful strength, which it does, but in the long run" he suggested, "Japan is going to pay a price for this homogeneity and cultural distinctiveness." I think that we do need to recognize and build on the strengths and opportunities that federalism and regional diversity provides rather than say that the only way we can participate effectively in the world is to deny aspects of our fundamental self.

To return to the Meech Lake theme, it seems to me that we will not be able to respond to these challenges if we are forced to continue to devote as many of our energies and passions to resolving our internal differences as we have at the moment. It seems to me that generally we are extraordinarily preoccupied with ourselves while the world is changing around us, and it seems to me we need to get this concern about ourselves behind us so that we can devote our energies to scanning the world more thoroughly.

Session V — Digest of Discussion

Before the discussion began for the final session, chairperson Jake Warren paid tribute to a prominent scholar in the field of trade relations:

> Occasionally, we have to also remember that not all of the people who would like to be with us can be with us and in this great effort at trying to build a Canada there are literally hundreds and thousands that should have been here for this discussion but there's one man in particular who should have been here. His name is Frank Stone. He was a GATT negotiator for Canada and one of our leading scholars in writing about commercial policy from the Canadian point of view and a superb human being who is no longer here. (Frank Stone died in December 1989.)

The chair then elicited comments from invited guests from outside Canada to provide their unique perspectives on globalization and the Canadian federation. André Sapir, for example, drew a parallel between the domestic debates in Canada and his native Belgium, acknowledging the dire need for both countries to put their domestic institutional squabbles behind them in order that more energy could be devoted to the global agenda.

On the European level, he asserted that a smaller country like Belgium *does* play a significant role in trade policy given that controlling access to its domestic markets provides a considerable degree of negotiating leverage. Reflecting on the last 30 years of trade negotiations, and particularly the evolution of practices in the EC, Sapir found it surprising that Canada has still not developed a formal institutional framework to allow for actual voting by the provincial governments on issues raised or agreements achieved at multilateral trade negotiations. Further, he acknowledged that in countries such as Belgium and Canada where the approach to negotiations is typically pragmatic and the emphasis is on compromise solutions, it will always be easier to achieve agreement on a more protectionist stance, particularly given the persistence of "blocking minorities."

With a view from south of the border, William Diebold of the Council on Foreign Relations in New York offered a number of observations as well as suggestions for future discussions flowing from the conference agenda. He defined globalization in the international economic context as not merely "one stage beyond interdependent" economies but as a world of "interpenetrated economies." The concept of globalization as applied to Canada provoked three further observations from Diebold. One was that globalization is beginning to give Canada the diversification in trade and investment that decades of policy could not achieve. Another is the fact that it enhances the need for "one voice" because it multiplies the country's international economic relations, but at the same time it also makes the message of one voice more confused (i.e., how do you define truly *national* interests anymore?). Finally, if the impact of globalization on the United States is to increase its propensity towards bilateral relations, what will this mean for Canada? Will the Americans finally acknowledge the real importance of its relationship with its northern neighbour or will the U.S. pay even more attention to the rest of the world at the expense of Canada?

In offering an agenda for future discussions, Diebold emphasized the need to talk more with business and about business, as globalization is largely a business-created phenomenon. For example, does business escape or can it ignore national policies? In terms of federalism, is business more influential when government is more centralized or more decentralized? Given recent developments in Europe and the Soviet Union, what of the future of federalism itself?

Alan Nymark, the former Assistant Chief Negotiator at the Trade Negotiations Office, directed his comments towards issues of federalism as they related to the prior free trade negotiations with the United States. For example, he argued that at least in part both the procurement and the subsidies agreements fell apart because the United States could not or chose not to manage its federation in order to gain the consensus needed for a comprehensive deal. In terms of the Canadian approach to these negotiations, Nymark believed that two important lessons learned in the attempt to achieve "full provincial participation" were that continuous, not episodic, dialogue is necessary; and, that you have to focus on substance, more so than process, in such negotiations.

Likening the process endured under the free trade negotiations to a four-ring circus — one of each occupied by representatives of the United States, the private sector, other federal departments and the provinces — Nymark reflected particularly on the costs and benefits of federal-provincial consultation from a federal negotiator's perspective. Clearly, the costs are higher than in a unitary state. Nymark estimated that in the six months immediately prior to the formal commencement of the comprehensive negotiations, Chief Negotiator Reisman spent nearly 80 percent of his time negotiating with the provinces — time that perhaps could have been spent directly preparing for the bilateral U.S. negotiations. Costs can become particularly high when any one of the members at the table attempts to exercise a veto.

On the other hand, the benefits of full provincial participation are numerous. Nymark drew attention to the continuous diversity of views that were expressed, which is critical given the complexity of the concepts of globalization and of federalism. Moreover, the type of discussions held at the federal-provincial level, although professional amongst bureaucrats, was highly reflective of the political sentiments in the country and therefore extremely valuable for the federal negotiators to have first hand. Nymark argued that in the final analysis, it was invaluable to the Chief Negotiator to have had on each occasion before meeting with the Americans more than a full practice run with the provinces on specific negotiating issues. According to Nymark, while "managing the federation is difficult and time consuming, ... there is no alternative."

Le Fédéralisme Canadien: A l'épreuve du défi économique mondial/
Canadian Federalism: Global Economic Challenges
les 29-30 mars, 1990/29-30 March 1990

PARTICIPANTS

NOM/NAME	ORGANISATION/ ORGANIZATION	LOCALISATION/ LOCATION
David Barrows	Ministry of Industry, Trade and Technology, Ontario	Toronto
Jean-François Bence	The Institute for Research on Public Policy	Ottawa
Anne Bernard	Ministère des Affaires internationales	Québec
Ivan Bernier	Université Laval	Québec
André Binette	Secrétariat aux Affaires intergouvernementales canadiennes	Québec
Chris Bredt	Ministry of the Attorney General, Ontario	Toronto
Douglas M. Brown	Institute of Intergovernmental Relations, Queen's University	Kingston
Alexander Bryce	External Affairs and International Trade, Canada	Ottawa
David Cameron	Ministry of Intergovernmental Affairs, Ontario	Toronto
Anthony Careless	Ministry of the Attorney General, Ontario	Toronto
Roger Charbonneau	L'Institut de recherches politiques	Montréal
John Ciaccia	Gouvernement du Québec	Québec
Wayne Clifford	Federal and Intergovernmental Affairs, Alberta	Edmonton

NOM/NAME	ORGANISATION/ ORGANIZATION	LOCALISATION/ LOCATION
David Cohen	Bureau des relations fédérales-provinciales, Gouvernement du Canada	Montréal
Peter Cook	Globe & Mail	Toronto
Thomas J. Courchene	Queen's University	Kingston
Stuart Culbertson	Ministry of International Business and Immigration, British Columbia	Victoria
David Crane	The Toronto Star	Toronto
Shannon Day	Report on Free Trade	Ottawa
Germain A. Denis	Affaires extérieures et Commerce extérieur	Ottawa
William Diebold	Council on Foreign Relations	New York
Rod Dobell	The Institute for Research on Public Policy	Victoria
Reg Dorrett	External Affairs and International Trade, Canada	Ottawa
Geoffrey Elliot	Noranda Forest Inc.	Toronto
Patrick Fafard	Ministry of Intergovernmental Affairs, Ontario	Ottawa
Elliot Feldman	Steptoe & Johnson	Washington
Earl Fry	Brigham Young University	Utah
François Gauthier	Affaires extérieures et Commerce extérieur	Ottawa
Carl Grenier	Ministère des Affaires internationales	Québec
Allan Gotlieb	Stikeman Elliott	Toronto
Dwight Herperger	Institute of Intergovernmental Relations, Queen's University	Kingston
Robert Herzstein	Shearman & Sterling	Washington

NOM/NAME	ORGANISATION/ ORGANIZATION	LOCALISATION/ LOCATION
Michael Kalnay	Parliamentary Centre for Foreign Affairs and Foreign Trade	Ottawa
Robert Knox	Industry, Science and Technology, Canada	Ottawa
Peter Leslie	Federal-Provincial Relations Office, Government of Canada	Ottawa
Richard Lyall	Ministry of Industry Trade and Technology, Ontario	Toronto
André Marcheterre	Merck Frosst Canada Inc.	Pointe Claire-Dorval
James D. McNiven	Dalhousie University	Halifax
Harold Millican	YYC Investments Inc.	Calgary
Nickolas Murray	Consumers Association of Canada	Halifax
Alan Nymark	Investment Canada	Ottawa
Don Padget	Parliamentary Intern	Ottawa
Robert Perrin	Saskatchewan Trade and Investment	Regina
Marisa Piattelli	Ministry of Intergovernmental Affairs, Ontario	Toronto
Harry Quinlan	Department of Commerce and Technology, New Brunswick	Fredericton
François Raynauld	Gouvernement du Québec	Québec
Robert Richards	Department of Justice, Saskatchewan	Saskatchewan
Gordon Robertson	Former Clerk of the Privy Council and Secretary to the Cabinet	Ottawa
André Sapir	Free University	Brussels
Marvin Schneider	Federal and Intergovernmental Affairs, Alberta	Edmonton

NOM/NAME	ORGANISATION/ ORGANIZATION	LOCALISATION/ LOCATION
Lorne Seitz	Ministry of International Business and Immigration, British Columbia	Victoria
Scott Serson	Federal-Provincial Relations Office, Government of Canada	Ottawa
Richard Simeon	Queen's University	Kingston
Murray G. Smith	The Institute for Research on Public Policy	Ottawa
Marc St. Laurent	Affaires extérieures et Commerce extérieur	Ottawa
Ken Sunquist	External Affairs and International Trade, Canada	Ottawa
Donald Tate	Industry, Science and Technology, Canada	Ottawa
Barbara Tink	External Affairs and International Trade, Canada	Ottawa
Rodrigue Tremblay	Université de Montréal	Montréal
John Trickett	Consultex Canada Inc.	Montréal
Debrah Tunis	External Affairs and International Trade, Canada	Ottawa
Konrad von Finckenstein	External Affairs and International Trade, Canada	Ottawa
Jake Warren	Gouvernement du Québec	Ottawa
Christopher Watts	Premier's Office	Victoria
Ronald Watts	Institute of Intergovernmental Relations, Queen's University	Kingston

Institute for Research on Public Policy

Founded in 1972, The Institute for Research on Public Policy is an independent, national, non-profit organization with offices across Canada.

The mission of the Institute is to improve public policy in Canada by promoting and contributing to a policy process that is more broadly based, informed and effective.

In pursuit of this mission, the Institute:

- identifies significant public policy questions that will confront Canada in the longer term future, and undertakes independent research into those questions;
- promotes wide dissemination of key results from its own and other research activities;
- encourages non-partisan discussion and criticism of public policy issues in a manner which elicits broad participation from all sectors and regions of Canadian society, and links research with processes of social learning and policy formation.

The Institute is decentralized, employing researchers across Canada. This ensures that research undertaken by the Institute involves contributions from all regions. The Institute also works with individual researchers or institutes in other countries.

The Institute's independence is assured by an endowment fund, to which federal and provincial governments and the private sector have contributed.

Institut de recherches politiques

Créé en 1972, l'Institut de recherches politiques est un organisme national et indépendant à but non lucratif, possédant des bureaux d'un bout à l'autre du Canada.

La mission de l'Institut est d'améliorer la politique d'État au Canada en encourageant un processus politique plus général, mieux informé et plus efficace et en contribuant à la mise en application de ce processus.

Pour remplir cette mission, l'Institut:

- identifie les questions importantes auxquelles devra faire face le Canada dans un avenir à long terme et entreprend des recherches indépendantes sur ces questions;
- favorise la dissémination générale des résultats-clés des activités de recherches (celles menées par l'Institut et d'autres);
- encourage le débat impartial et la critique de questions de politique d'État, de manière à provoquer la participation de tous les secteurs et de toutes les régions de la société canadienne, et établit la liaison entre la recherche et les mécanismes d'apprentissage social et d'élaboration de politiques.

L'Institut est décentralisé; ses chercheurs sont établis d'un bout à l'autre du Canada, ce qui permet d'assurer que toutes les régions contribuent aux recherches entreprises. L'Institut travaille également en collaboration avec des chercheurs particuliers ou des instituts d'autres pays.

L'indépendance de l'Institut est assurée par les revenus d'un fonds de dotation auquel ont souscrit les gouvernements fédéral et provinciaux, ainsi que le secteur privé.

Institute of Intergovernmental Relations
Queen's University
(Published in association with the
School of Policy Studies)

Institute for Research on Public Policy

Price: $15.00
Printed in Canada

ISBN 0-88911-574-5

Canadian Federalism: Meeting Global Economic Challenges?

Edited by DOUGLAS M. BROWN and MURRAY G. SMITH

Is the Canadian federal system meeting the challenges of a global economy? How is the global economy changing Canadian federalism? These questions were addressed by a conference of Canada's international trade and investment policy-makers at Mont-Gabriel, Quebec, in March 1990. These proceedings explore the complexity of the global economic challenges facing Canada and assess the strengths and weaknesses of federalism for recent policy-making in Canada.

Contributors include: **David Barrows, Ivan Bernier, Douglas M. Brown, Roger Charbonneau, John Ciaccia, Wayne Clifford, Thomas J. Courchene, Stuart Culbertson, Germain A. Denis, Earl Fry, Allan Gotlieb, Carl Grenier, Robert Herzstein, Gordon Jansen, James D. McNiven, Alan Nymark, Robert Richards, Gordon Robertson, André Sapir, Lorne Seitz, Richard Simeon, Murray G. Smith and Jake Warren.**